ENTERPRISE ZONES—1982

HEARING

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

S. 1829 and S. 2298

APRIL 21, 1982

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ENTERPRISE ZONES—1982

WEDNESDAY, APRIL 21, 1982

U.S. SENATE,
SUBCOMMITTEE ON SAVINGS, PENSIONS,
AND INVESTMENT POLICY,
COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:34 a.m., in room 2221, Dirksen Senate Office Building, Hon. John H. Chafee (chairman) presiding.

Present: Senators Dole and Chafee.

Also present: Senators Heinz, Boschwitz, Huddleston, and Bradley.

[The press release announcing the hearing, prepared statements of Senators Chafee and Danforth, the text of bills S. 1829 and S. 2298, and background material on enterprise zones follow:]

[Press Release No. 82-121]

FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY CANCELS HEARINGS ON ENTERPRISE ZONES

Senator John Chafee, Chairman of the Subcommittee on Savings, Pensions, and Investment Policy, announced today that the Subcommittee hearings on Enterprise Zones scheduled for April 15 and April 16, 1982, have been cancelled. The hearings are being rescheduled for an early date. A new date for the hearings will be announced as soon as possible.

[Press Release No. 82-124]

FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY RESCHEDULES HEARINGS ON ENTERPRISE ZONES

Senator John Chafee, Chairman of the Subcommittee on Savings, Pensions, and Investment Policy, announced today that the Subcommittee hearings on Enterprise Zones have been rescheduled for the morning and afternoon of Wednesday, April 21, 1982. The morning session will begin at 9:30 a.m., and the afternoon session will begin at 2:00 p.m., in Room 2221, Dirksen Senate Office Building.

STATEMENT BY SENATOR JOHN H. CHAFEE

Good morning and welcome to the initial Congressional hearings on the Enterprise Zone Tax Act of 1982. This legislation, which is the Administration's proposal, represents a major contribution by President Reagan to the redevelopment of economically distressed cities and towns throughout America.

Those of us who have worked on the enterprise zone concept over the last two years welcome the Administration's strong support because it is crucial to the success of our legislative efforts this year. As it is a key part of the President's economic recovery program, I and the other 25 Senate co-sponsors of the Enterprise Zone Tax Act will pull out all the stops to assure its enactment during this session.

We are privileged to have the Administration's lead spokesman for the enterprise zone issue testifying before the Subcommittee today, Department of Housing and Urban Development Secretary Pierce. In addition, Treasury Assistant Secretary Chapoton will review the bill's tax provisions and Commerce Assistant Secretary Brady will discuss the possible role of Foreign Trade Zones within enterprise zones.

Following the witnesses from the Executive Branch, we will hear testimony from a number of state and local officials who will comment on the progress of enterprise zone legislation in their own jurisdictions and, hopefully, on the compatibility of zone legislation being developed at both the state and federal levels.

The remaining private sector witnesses will, I expect, have some advice for the Subcommittee on other issues which have persisted throughout our work on enterprise zones for the last two years:

Are there adequate incentives in the bill to encourage startup of new small businesses?

Is the program too complex for unsophisticated entrepreneurs to take advantage of?

What will be the impact on zone residents?

How about the effect on employers located just outside the zone?

We look forward to these and other comments the witnesses may have and hope that we can work together to enact the best possible enterprise zone bill.

STATEMENT OF SENATOR JOHN C. DANFORTH

Today, the Savings, Pensions, and Investment Policy Subcommittee, chaired by my colleague Senator Chafee, will be examining S. 2298, a plan to establish enterprise zones in impoverished urban and rural communities across the nation. I commend in particular Chairman Chafee and Senator Boschwitz and their staffs for their thorough research and preparation and their willingness to work with the Administration in turning the exciting possibilities of the enterprise zone concept into a workable legislative proposal. Likewise, the Administration is to be praised for the substantial resources that have been put into the development of the enterprise zone concept.

As the enterprise zone concept has been discussed and promoted in this country, its essential features are to offer tax incentives and regulatory relief to entice businesses, and thus new jobs, back into distressed areas. Unlike many existing Federal programs that have attempted to solve these same problems, enterprise zone legislation seeks to encourage new and expanded enterprise activity through these two very important incentives, rather than by merely offering Federal money to spur economic development.

However, economic development demands capital resources. There are a variety of market barriers that reduce the availability of capital to entrepreneurs and young, growing firms—the principal job creators and innovators in our economy. These problems are intensified in the highly distressed areas of our communities, and they represent severe problems for both rural as well as urban areas of the nation.

Research strongly suggests that small business development will bring about the desired recovery of distressed sectors of our cities through commercial economic development. The approach of an enterprise zone is in sharp contrast to past programs that have emphasized attracting major industry into distressed communities. Therefore, it is particularly important, as this panel deliberates on S. 2298, that this important concept, the enterprise zone, be tested adequately in the widest possible variety of circumstances—urban and rural. That the most significant need of small and young firms—on which most of the promise of the enterprise zone rests—be addressed, the need for venture capital.

As a cosponsor of S. 2298 and a member of the Senate Finance Committee, and the sponsor of an enterprise zone proposal which focused on the particular needs of small businesses and rural communities, I am pleased with the timeliness of this hearing and the wide spectrum of interests and views that will be offered to this panel as it continues to refine the legislation. I have been a supporter of the testing of this pioneering proposal, in urban as well as rural contexts. I am most encouraged by the steady improvement that the legislation has made over the past two years. There remains, however, room for improvement and I hope to be able to work with the Committee and the other sponsors of S. 2298 in enacting an effective new tool for the revitalization of our distressed communities.

I would like to request that S. 1829, the rural enterprise zone bill which I introduced last November, be included in the hearing record as background to my comments.

II

97TH CONGRESS
1ST SESSION

S. 1829

To amend the Internal Revenue Code of 1954 to provide certain tax incentives for individuals and businesses in depressed rural areas, and for other purposes.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 9 (legislative day, NOVEMBER 2), 1981

Mr. DANFORTH (for himself, Mr. ANDREWS, Mr. GRASSLEY, Mr. LAXALT, and Mr. SCHMITT) introduced the following bill; which was read twice and referred to the Committee on Finance

---

A BILL

To amend the Internal Revenue Code of 1954 to provide certain tax incentives for individuals and businesses in depressed rural areas, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; AMENDMENT OF 1954 CODE.

(a) SHORT TITLE.—This Act may be cited as the "Rural Enterprise Zone Act of 1981".

(b) AMENDMENT OF 1954 CODE.—Unless otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

TITLE I—DESIGNATION OF RURAL ENTERPRISE ZONES

SEC. 101. DESIGNATION OF ZONES.

(a) RURAL ENTERPRISE ZONE DEFINED.—

(1) IN GENERAL.—For purposes of this Act, the term "rural enterprise zone" means any area in the United States with respect to which the Secretary of Commerce approves a request for designation as a rural enterprise zone made by a person described in paragraph (3).

(2) APPLICATION.—The Secretary of Commerce may not approve any designation under paragraph (1) unless an application therefor is submitted in such form and contains such information as the Secretary of Commerce may by regulations prescribe.

(3) PERSONS MAKING REQUESTS.—A request for designation of an area as a rural enterprise zone under this section may be made by—

(A) a State government on behalf of one or more local government or governments if the local governments consent to such request;

(B) a local government or governments with jurisdiction over such area; or

(C) any other person which, as determined by the Secretary of Commerce, has the consent of the local governments, is representative of the zone eligible population, and has the administrative capacity to manage a zone jointly with the local governments.

(b) REVOCATION OF DESIGNATION.—

(1) IN GENERAL.—The Secretary of Commerce may revoke any designation of an area if the Secretary of Commerce determines that the requirements of this title are not being met with respect to such area. Before revoking any designation, the Secretary may allow periods for remedial action to be taken.

(2) AUTOMATIC REVOCATION AFTER 15 YEARS.—Any designation of an area as a rural enterprise zone shall automatically expire after 15 years.

(c) AREA REQUIREMENTS.—

(1) IN GENERAL.—The Secretary of Commerce may approve the designation request of any area under subsection (a) only if—

(A) the area is within the jurisdiction of the government designating such area or jointly involved in managing such area,

(B) the boundary of the area is continuous,

(C) the area—

(i) is located outside of a standard metropolitan statistical area, or

(ii) is otherwise determined by the Secretary of Commerce to be a rural area;

(D) the area—

(i) has a population of at least 600,

(ii) comprises an incorporated separate jurisdiction, or

(iii) is an Indian reservation (as determined by the Secretary of the Interior);

(E) the area does not contain any prime agricultural land (as defined by the Secretary of Commerce after consultation with the Secretary of Agriculture); and

(F) the area meets the requirements of paragraph (2).

(2) UNEMPLOYMENT AND POVERTY REQUIREMENTS.—For purposes of paragraph (1), an area meets the requirements of this paragraph if such area meets the unemployment and income criteria for cities with populations of less than 50,000 under the urban development action grant program administered by the Secretary of Housing and Urban Development.

(3) DETERMINATION MADE BY SECRETARY OF COMMERCE.—Determinations under this subsection shall be made by the Secretary of Commerce on the basis of—

(A) data submitted by the government designating the area if the Secretary determines that such data is reasonably accurate, and

(B) the most recent census data available.

(d) RURAL ENTERPRISE ZONE PLAN.—

(1) IN GENERAL.—Each person requesting the Secretary of Commerce to approve a request for designation of an area as a rural enterprise zone shall submit a rural enterprise zone plan.

(2) REQUIREMENTS OF PLAN.—Each rural enterprise zone plan submitted under paragraph (1) shall document commitment, shall analyze probable costs and benefits from use of the incentives for economic benefit, and shall—

(A) describe the local efforts or contributions which will be made in the area to increase employment and to encourage the formation and expansion of business enterprises and general economic development, including any local concessions to be made such as—

(i) tax abatement,

(ii) the providing of State, local, and private loans, loan guarantees, industrial revenue bonds, and other financing incentives for financing businesses in the area,

(iii) the providing of local government services (such as infrastructure, transportation, sewage, utility, and zoning) to support business and economic development,

(iv) the providing of education, training, and employment to residents of the area who are eligible for assistance under the Comprehensive Employment and Training Act,

(v) making available to residents of the area public services which encourage their entry into the workplace,

(vi) the commitment of land and buildings for economic development,

(vii) the providing of technical and management assistance, and

(viii) the creation of a loan fund for businesses within the area,

(B) guarantee the ability of any government with jurisdiction over the area to manage the zone, including, but not limited to, the ability to—

(i) certify residents eligible for tax or other assistance, and

(ii) carry out the local efforts and contributions described in subparagraph (A),

(C) describe—

(i) the degree of involvement in the zone by local economic development organizations,

(ii) past accomplishments and performance and existing development efforts of the area, and

(iii) private sector activities and potential,

(D) demonstrate that the area meets the requirements of subsection (c), and

(E) describe the planned use of existing Federal resources for economic development and how such use will enhance any tax or regulatory incentives provided by this Act.

(3) USE OF AND ASSISTANCE IN PREPARING PLANS.—The Secretary of Commerce shall—

(A) take any plan submitted under this subsection into consideration in determining whether to approve a designation as a rural enterprise zone,

(B) if an area is approved as a rural enterprise zone, require that the local effort described in paragraph (2)(A) be made, and

(C) make every effort to reduce the burdens on any person seeking to submit a plan, including giving technical assistance to such person.

SEC. 102. NUMBER OF ZONES.

(a) In General.—The Secretary of Commerce—

(1) may approve requests for designations of areas as rural enterprise zones under section 101 only during the 3-calendar year period beginning with the first calendar year beginning after the date of the enactment of this Act, and

(2) may not approve more than 15 requests for designations of areas as rural enterprise zones during any calendar year.

(b) Preferences in Approving Zones.—In approving areas as rural enterprise zones, the Secretary of Commerce shall give preference to requests which—

(1) demonstrate broad community support,

(2) demonstrate the ability to make available nonresidential property which is appropriately zoned for commercial use,

(3) demonstrate that the governments with jurisdiction over the area will make the local commitments described in section 101(c), and

(4) minimize Federal expenditures.

SEC. 103. MANAGEMENT OF RURAL ENTERPRISE ZONE.

(a) IN GENERAL.—Subject to the authority of the Secretary of Commerce to revoke his approval of the designation of an area as a rural enterprise zone, the Secretary of Commerce shall contract with the person submitting the request for approval for the management of such area and such person shall be responsible for such management and compliance with the provisions of this title.

(b) THIRD PARTY MANAGEMENT.—A person described in subsection (a) may contract with another person to carry out its responsibilities under this section.

SEC. 104. SENSE OF CONGRESS WITH RESPECT TO DESIGNATIONS OF FOREIGN TRADE ZONES.

It is the sense of the Congress that in the case of any request for designation of an area in a rural enterprise zone as a foreign trade zone—

(1) the Foreign Trade Zone Board should expedite the application process as much as possible;

(2) in evaluating such application, the Board should take into account not only current economic development in the rural enterprise zone but also future

development to be expected from the incentives offered by this Act; and

(3) the Board should provide technical assistance to the applicants.

TITLE II—TAX INCENTIVES

Subtitle A—Capital Gains Tax Rates

SEC. 201. CORPORATIONS.

(a) General Rule.—Subsection (a) of section 1201 (relating to alternative tax for corporations) is amended by striking out paragraph (2) and inserting in lieu thereof the following:

"(2) a tax of 10 percent of the lesser of—

"(A) the net capital gain, or

"(B) the net capital gain determined by only taking into account sales or exchanges of qualified property, plus

"(3) a tax of 28 percent of the excess (if any) of—

"(A) the net capital gain for the taxable year, over

"(B) the amount of net capital gain taken into account under paragraph (2).".

(b) Definition of Qualified Property.—Section 1201 (relating to alternative tax for corporations) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) DEFINITION OF QUALIFIED PROPERTY.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified property' means—

"(A) any tangible personal property which was used predominantly by the taxpayer in a rural enterprise zone in the active conduct of a trade or business;

"(B) any real property (other than land) located in such a zone which was used predominantly by the taxpayer in the active conduct of a trade or business; and

"(C) any interest in a corporation, partnership, or other entity if, for the most recent taxable year of such entity ending before the date of the sale or exchange, such entity was a qualified business.

"(2) QUALIFIED BUSINESS.—

"(A) IN GENERAL.—The term 'qualified business' means any person—

"(i) which is actively engaged in the conduct of a trade or business during such taxable year,

"(ii) which is not—

"(I) a member of a controlled group of corporations (within the meaning of section 1563(a)(1), except that 'more than 50 percent' shall be substituted for 'at least 80 percent' in section 1563(a)(1)), and

"(II) is not a member of a group of trade or businesses which are under common control (as determined under regulations prescribed by the Secretary based on principles similar to principles which apply in the case of subclause (I)),

"(iii) which—

"(I) was incorporated or began the active conduct of such trade or business not more than 5 years preceding the last day of the taxable year, or

"(II) is a small business (as determined by the Administrator of the Small Business Administration),

"(iv) with respect to which at least 50 percent of such person's gross receipts for the taxable year are attributable to the active conduct of a trade or business within a rural enterprise zone, and

"(v) derives, during any taxable year, less than 50 percent of its aggregate gross receipts from sources other than royalties, rents, dividends, interests, annuities, and sales or exchanges of stocks and securities (as determined under rules similar to the rules provided in section 1244(c)(1)(C) and (c)(2)(A) or (B)).

"(B) EXISTING BUSINESS.—Any person which—

"(i) was actively engaged in the conduct of a trade or business in an area immediately before such area is designated as a rural enterprise zone, and

"(ii) otherwise meets the requirements of this paragraph,

shall not be treated as a qualified business unless the average number of employees (determined on a full-time basis) during the taxable year is at least 10 percent greater than the average number of such employees during the taxable year preceding the designation of such area as a rural enterprise zone.

"(3) PROPERTY REMAINS QUALIFIED AFTER ZONE DESIGNATION CEASES TO APPLY.—

"(A) IN GENERAL.—The treatment of property as qualified property under paragraph (1) shall not terminate when the designation of the area in which the property is located as a rural enterprise zone ceases to apply.

"(B) EXCEPTIONS.—Subparagraph (A) shall not apply after the first sale or exchange of property occurring after the designation ceases to apply to the zone.".

SEC. 202. TAXPAYERS OTHER THAN CORPORATIONS.

Subsection (a) of section 1202 (relating to deduction for capital gains) is amended to read as follows:

"(a) DEDUCTION ALLOWED.—

"(1) IN GENERAL.—If for any taxable year a taxpayer other than a corporation has a net capital gain, there shall be allowed as a deduction from gross income an amount equal to the sum of—

"(A) 80 percent of the lesser of—

"(i) the net capital gain, or

"(ii) the net capital gain determined by only taking into account sales or exchanges of qualified property (as defined in section 1201(d)), plus

"(B) 60 percent of the excess (if any) of—

"(i) the net capital gain, over

"(ii) the amount of the net capital gain taken into account under subparagraph (A).

"(2) PROPERTY REMAINS QUALIFIED AFTER ZONE DESCRIPTION CEASES TO APPLY.—

"(A) IN GENERAL.—The treatment of property as qualified property under paragraph (1) shall not terminate when the designation of the area in which the property is located or used as a rural enterprise zone ceases to apply.

"(B) EXCEPTIONS.—Subparagraph (A) shall not apply after the first sale or exchange of property occurring after the designation to the zone.".

SEC. 203. MINIMUM TAX.

(a) CAPITAL GAINS.—Paragraph (9) of section 57(a) (relating to tax preference for capital gains) is amended by adding at the end thereof the following new subparagraph:

"(E) SALES OF CERTAIN PROPERTY NOT TAKEN INTO ACCOUNT.—For purposes of this paragraph, sales or exchanges of qualified property (as defined in section 1201(d)) shall not be taken into account.".

(b) ACCELERATED DEPRECIATION.—Paragraph (2) of section 57(a) (relating to accelerated depreciation on real property) is amended by adding at the end thereof the following: "The preceding sentence shall not apply to any section 1250 property which is qualified property (within the meaning of section 1201(d)).".

(c) RECOVERY PROPERTY.—Paragraph (12) of section 57(a) (relating to accelerated cost recovery deduction) is amended by adding at the end thereof the following new subparagraph:

"(E) QUALIFIED PROPERTY.—This paragraph shall not apply to any recovery property which is qualified property (within the meaning of section 1201(d)).".

SEC. 204. NONRECOGNITION OF GAIN ON ANY PROPERTY SOLD WHERE QUALIFIED PROPERTY ACQUIRED.

(a) IN GENERAL.—Part III of subchapter O of chapter 1 (relating to nontaxable exchanges) is amended by adding at the end thereof the following new section:

"SEC. 1041. SALES OF PROPERTY WHERE QUALIFIED PROPERTY ACQUIRED.

"(a) NONRECOGNITION OF GAIN.—

"(1) IN GENERAL.—If any capital asset is sold by the taxpayer and, within the 1-year period beginning on the date of such sale, any qualified property is purchased by the taxpayer, gain (if any) from such sale shall, at the election of the taxpayer, be recognized only to the extent that the amount realized on such sale exceeds the cost to the taxpayer of such property.

"(2) ELECTION.—The election under paragraph (1) shall be made by filing, not later than the last day prescribed by law (including extensions thereof) for filing the return of tax imposed by this chapter for the taxable year in which the sale occurs, with the Secretary a statement (in such manner as the Secretary may by regulations prescribe) of such election.

"(b) SPECIAL RULES FOR EXCHANGE.—For purposes of this section, an exchange by the taxpayer of any capital asset for other property shall be treated as a sale of such asset, and the acquisition of any qualified property on the exchange of property shall be treated as a purchase of such qualified property.

"(c) REDUCTION OF BASIS.—Where the purchase of any qualified property results under subsection (a) in the nonrecognition of gain on the sale of any asset, the basis of such asset shall be reduced by an amount equal to the amount of gain not so recognized on the sale of such asset. Where the purchase of more than one qualified property is taken into account in the nonrecognition under subsection (a) of gain on the sale of an asset, the preceding sentence shall be applied to each qualified property in the order in which each such qualified property is purchased.

"(d) STATUTE OF LIMITATIONS.—If the taxpayer during any taxable year sells any property at a gain, then—

"(1) the statutory period for the assessment of any deficiency attributable to any part of such gain shall not expire before the expiration of the 3-year period beginning on the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) of—

"(A) the taxpayer's cost of purchasing any qualified property which the taxpayer claims results in nonrecognition of any part of such gain,

"(B) the taxpayer's intention not to purchase any qualified property within the 1-year period described in subsection (a), or

"(C) the failure by the taxpayer to purchase any qualified property within such period; and

"(2) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

"(e) QUALIFIED PROPERTY DEFINED.—For purposes of this section, the term 'qualified property' has the meaning given such term by section 1201(d).".

(b) TECHNICAL AMENDMENT.—Subsection (a) of section 1016 (relating to adjustments to basis) is amended by striking out "and" at the end of paragraph (23), by striking out the period at the end of paragraph (24) and inserting in lieu thereof "; and", and by adding at the end thereof the following new paragraph:

"(25) in the case of any qualified property (within the meaning of section 1201(d)) the acquisition of which resulted under section 1041 in the nonrecognition of gain on the sale or exchange of property, to the extent provided by section 1041(c).".

(c) CONFORMING AMENDMENT.—The table of sections for part III of subchapter O of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 1041. Sales of property where qualified property acquired.".

SEC. 205. EFFECTIVE DATE.

The amendments made by this subtitle shall apply to sales or exchanges after December 31, 1982, in taxable years ending after such date.

Subtitle B—Deduction for Investment in Certain Businesses

SEC. 211. DEDUCTION ALLOWED.

(a) IN GENERAL.—Part VI of subchapter B of chapter 1 (relating to itemized deductions for individuals and corporations) is amended by adding at the end thereof the following new section:

"SEC. 196. QUALIFIED INVESTMENT IN NEW AND SMALL BUSINESSES.

"(a) IN GENERAL.—There shall be allowed as a deduction for the taxable year an amount equal to the qualified investment of the taxpayer during the taxable year.

"(b) QUALIFIED INVESTMENT.—The term 'qualified investment' means the amount equal to the sum of—

"(1) the amount paid or incurred to purchase the stock or other equity interest of a qualified business, and

"(2) 50 percent of the principal amount of unsecured debt acquired by the taxpayer which has a maturity of 10 or more years and which was issued by a qualified business.

"(c) QUALIFIED BUSINESS.—The term 'qualified business' has the meaning given such term by section 1201(d)(2).".

(b) CONFORMING AMENDMENT.—The table of sections for part VI of subchapter B of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 196. Qualified investment in new and small businesses.".

SEC. 212. EFFECTIVE DATE.

The amendments made by this section shall apply to taxable years beginning after December 31, 1982.

Subtitle C—Targeted Jobs Credit Increased in Rural Enterprise Zones

SEC. 221. INCREASE IN TARGETED JOBS CREDIT.

(a) IN GENERAL.—Section 51 (relating to amount of credit for employment of certain new employees) is amended by adding at the end thereof the following new subsection:

"(j) SPECIAL RULES FOR RURAL ENTERPRISE ZONES.—

"(1) INCREASE IN AMOUNT OF CREDIT.—

"(A) IN GENERAL.—In any case in which—

"(i) the taxpayer is a qualified business (within the meaning of section 1202(d)(2)), and

"(ii) the employee is a member of a targeted group who—

"(I) is a qualified employee, or

"(II) is a resident of a rural enterprise zone,

then subsections (a) and (b)(4) shall not apply with respect to such employee and the amount of the credit allowable by section 44B with respect to the qualified wages of such employee shall be determined under subparagraph (B).

"(B) AMOUNT OF CREDIT.—For purposes of subparagraph (A), the amount of the credit allowable shall be equal to—

"(i) the sum of—

"(I) the qualified first-year wages of the employee to the extent such wages do not exceed $5,000, plus

"(II) 20 percent of the amount determined under subclause (I), plus

"(ii) the sum of—

"(I) the qualified second-year wages of the employee to the extent such wages do not exceed $3,000, plus

"(II) 10 percent of the amount determined under subclause (I).

"(2) RECAPTURE IF EMPLOYEE WORKS LESS THAN 1 YEAR.—If an employee is separated from employment with a taxpayer before the close of the 1-year period referred to in subsection (b)(2), the tax imposed by this chapter on the taxpayer for the taxable year in which such separation occurs shall be increased by an amount equal to 75 percent of the excess of—

"(A) the amount of the credit allowed for such taxable year and preceding taxable years with respect to such employee, over

"(B) the amount of such credit which would have been allowed without regard to this subsection.

"(3) QUALIFIED EMPLOYEE.—The term 'qualified employee' means an individual with respect to whom at least 50 percent of the services performed by the individual for the taxpayer during the taxable year are performed in a rural enterprise zone.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to wages paid or incurred after December 31, 1982.

Subtitle D—Credit for Certain Contributions

SEC. 231. CREDIT FOR CONTRIBUTIONS IN RURAL ENTERPRISE ZONE.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 (relating to credits allowable) is amended by inserting before section 45 the following new section:

"SEC. 44H. CONTRIBUTIONS TO RURAL ENTERPRISE ZONES.

"(a) IN GENERAL.—At the election of the taxpayer, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 5 percent of the taxpayer's qualified rural enterprise zone contributions for the taxable year.

"(b) Qualified Rural Enterprise Zone Contributions Defined.—For purposes of this section—

"(1) In general.—The term 'qualified rural enterprise zone contribution' means an amount equal to the sum of—

"(A) any amount paid to a qualified rural neighborhood organization but only to the extent such organization certifies to the taxpayer that such amount will be used to provide qualified rural services within a rural enterprise zone (or to pay reasonable administrative expenses in connection therewith), plus

"(B) the sum of—

"(i) the amounts paid for qualified public services provided in a rural enterprise zone, and

"(ii) the fair market value of qualified public services provided by the taxpayer in a rural enterprise zone.

"(2) Qualified public services.—The term 'qualified public services' means any of the following services provided to individuals or groups in a rural enterprise zone:

"(A) Any type of counseling and advice, emergency assistance, or medical care.

"(B) Assistance in the reduction of crime.

"(C) Scholastic instruction or scholarship assistance which enables an individual to prepare for better life opportunities.

"(D) Instruction which enables an individual to acquire vocational skills so that such individual may become employable or able to seek a higher grade of employment.

"(E) Furnishing financial assistance, labor, material, and technical advice to aid in the physical improvement of any part or all of the rural enterprise zone.

"(3) QUALIFIED RURAL NEIGHBORHOOD ORGANIZATION.—The term 'qualified rural neighborhood organization' means—

"(A) an organization which is described in section 501(c)(3) and which is exempt from taxation under section 501(a), or

"(B) an organization which has been designated as a community development corporation under title VII of the Economic Opportunity Act of 1964 (as in effect on September 30, 1980).

"(c) DENIAL OF DOUBLE BENEFITS.—No credit shall be allowed under this section with respect to any amount for which a deduction or credit is otherwise allowed under this title.".

(b) CONFORMING AMENDMENT.—The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by inserting before the item relating to section 45 the following new item:

"Sec. 44H. Contributions to rural enterprise zones.".

SEC. 232. EFFECTIVE DATE.

The amendments made by this subtitle shall apply to taxable years beginning after December 31, 1982.

Subtitle E—Miscellaneous

SEC. 241. OPTIONAL CASH METHOD OF ACCOUNTING FOR CERTAIN SMALL BUSINESSES.

Section 446 (relating to general rule for methods of accounting) is amended by adding at the end thereof the following new subsection:

"(f) OPTIONAL CASH METHOD.—

"(1) IN GENERAL.—Any taxpayer which is a qualified business (as defined in section 1201(d)(2)) for any taxable year beginning after December 31, 1982, may elect to compute taxable income—

"(A) under the cash receipts and disbursements method of accounting, and

"(B) without any requirement to use inventories under section 471.

"(2) GROSS RECEIPTS LIMITATION.—Paragraph (1) shall not apply for any taxable year with respect to any taxpayer if for any prior taxable year the gross receipts of such taxpayer exceeded $1,500,000.

"(3) ELECTION.—An election under paragraph (1) may be made by any taxpayer without the consent of the Secretary for the taxpayer's first taxable year for which the taxpayer is a qualified business.".

SEC. 242. BAD DEBT RESERVES.

(a) IN GENERAL.—Section 166 (relating to bad debts) is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) MINIMUM RESERVE FOR RURAL ENTERPRISE ZONE FINANCING.—At the election of the taxpayer, if the taxpayer—

"(1) provides goods or services to a qualified business (within the meaning of section 1201(d)(2)), and

"(2) provides trade credits in connection with such goods or services,

then, for purposes of subsection (c), the reasonable addition to a reserve for bad debts in connection with such credits shall be equal to 8 percent of the amount of such credits.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1981.

SEC. 243. DEFINITION OF RURAL ENTERPRISE ZONE.

Section 7701(a) (relating to definitions) is amended by adding at the end thereof the following new paragraph:

"(38) RURAL ENTERPRISE ZONE.—The term 'rural enterprise zone' means an area designated as a rural enterprise zone under title I of the Rural Enterprise Zone Act of 1981.".

TITLE III—REGULATORY FLEXIBILITY

SEC. 301. DEFINITION OF SMALL ENTITY FOR PURPOSES OF ANALYSIS OF REGULATORY FUNCTIONS.

Paragraph (6) of section 601 of title 5, United States Code, defining small entity, is amended to read as follows:

"(6) the term 'small entity' means—

"(A) a small business, small organization, or small governmental jurisdiction (within the meaning of paragraphs (3), (4), and (5), respectively), and

"(B) any qualified business (within the meaning of section 1201(d)(2) of the Internal Revenue Code of 1954), any government designating an area as a rural enterprise zone (within the meaning of title I of the Rural Enterprise Zone Act of 1981) to the extent any rule will affect such zone, and any not-for-profit enterprise operating within such zone.".

II

97TH CONGRESS
2D SESSION

S. 2298

Entitled "The Enterprise Zone Tax Act of 1982".

IN THE SENATE OF THE UNITED STATES

MARCH 30 (legislative day, FEBRUARY 22), 1982

Mr. CHAFEE (for himself, Mr. BOSCHWITZ, Mr. INOUYE, Mr. HEINZ, Mr. BURDICK, Mr. GORTON, Mr. HATCH, Mr. HAYAKAWA, Mr. JEPSEN, Mr. PERCY, Mr. QUAYLE, Mr. KASTEN, Mr. D'AMATO, Mr. GRASSLEY, Mr. GARN, Mrs. HAWKINS, Mr. MATTINGLY, Mr. MATSUNAGA, Mr. RUDMAN, Mr. SIMPSON, Mr. TOWER, Mr. ANDREWS, and Mr. JOHNSTON introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

Entitled "The Enterprise Zone Tax Act of 1982".

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; AMENDMENT OF 1954 CODE.

(a) SHORT TITLE.—This Act may be cited as the "Enterprise Zone Tax Act of 1982".

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

TITLE I—DESIGNATION OF ENTERPRISE ZONES

SEC. 101. DESIGNATION OF ZONES.

(a) GENERAL RULE.—Chapter 80 (relating to general rules) is amended by adding at the end thereof the following new subchapter:

"Subchapter C—Designation of Enterprise Zones

"Sec. 7871. Designation.

"(a) DESIGNATION OF ZONES.—

"(1) ENTERPRISE ZONES DEFINED.—For purposes of this title, the term 'enterprise zones' means—

"(A) any area in the United States which is nominated by one or more local governments and the State in which it is located,

"(B) which the Secretary of Housing and Urban Development, after consultation with the Secretaries of Agriculture, Commerce, Labor and the Treasury, the Director of the Office of Management and Budget, and the Administrator of the Small Business Administration, and, in the case of an enterprise zone on an Indian reservation, the Secretary of the Interior, designates to be an enterprise zone.

"(2) LIMITATIONS ON DESIGNATION.—

"(A) PUBLICATION OF REGULATIONS.—Prior to designating any area as an enterprise zone, the Secretary of Housing and Urban Development shall prescribe by regulation after consultation with the officials described in paragraph (1)(B)—

"(i) the procedures for nomination,

"(ii) the parameters relating to the size and population characteristics of an enterprise zone,

"(iii) other standards which a nominated area must meet to be designated as an enterprise zone, and

"(iv) the manner in which nominated areas will be compared based on the criteria specified in subsection (d) and the other factors specified in subsection (e).

"(B) TIME LIMITATIONS.—The Secretary of Housing and Urban Development may designate areas as enterprise zones only during the period beginning on the effective date of the regulations described in paragraph (2)(A), but not later than January 1, 1983, and ending on the final day of the 36th full calendar month following such date.

"(C) NUMBER OF DESIGNATIONS.—During each of the 12-month periods following the effective date of such regulations, the Secretary of Housing and Urban Development shall designate not more than 25 nominated areas as enterprise zones.

"(D) PROCEDURAL RULES.—The Secretary of Housing and Urban Development shall not make any designation under paragraph (1)—

"(i) unless the local government and the State in which the nominated area is located have the statutory authority to nominate such area for designation as an enterprise zone and to make the State and local commitments under subsection (d), and provide assurances satisfactory to the Secretary of Housing and Urban Development that such commitments will be fulfilled,

"(ii) unless a nomination therefor is submitted in such manner and in such form, and contains such information, as the Secretary of Housing and Urban Development shall by regulations prescribe, "(iii) unless the Secretary of Housing and Urban Development determines that such information is reasonably accurate, and

"(iv) unless the Secretary determines that no portion of the area nominated is already included in an enterprise zone or in an area nominated as an enterprise zone.

"(3) NOMINATION PROCESS.—

"(A) STATE AND LOCAL NOMINATION.—A nomination under this subsection shall be made first by a local government, followed by confirming nomination by the State government, or first by the State government, followed by confirming nomination by the local government.

"(B) INDIAN RESERVATIONS.—In the case of a nominated enterprise zone on an Indian reservation, the reservation governing body as determined by the Secretary of the Interior shall be deemed to be both the State and local government for such reservation.

"(b) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—

"(1) IN GENERAL.—Any designation of an area as an enterprise zone shall remain in effect during the period beginning on the date of the designation and ending on the earlier of—

"(A) December 31 of the 24th year after such date,

"(B) the date designated by the approving State and local governments as set forth in their nomination application, or

"(C) the date the Secretary of Housing and Urban Development revokes such designation under paragraph (2).

"(2) REVOCATION OF DESIGNATION.—The Secretary of Housing and Urban Development, after consultation with the officials described in subsection (a)(1)(B), may revoke the designation of an area if the Secretary of Housing and Urban Development determines that the local government or the State in which it is located is not complying substantially with the State and local commitments described in subsection (d).

"(c) AREA REQUIREMENTS.—

"(1) IN GENERAL.—The Secretary of Housing and Urban Development may make a designation of any area under subsection (a)(1) only if—

"(A) the area is within the jurisdiction of the local government, "(B) the boundary of the area is continuous,

"(C) the area—

"(i) has a population, as determined under the most recent census, of at least—

"(I) 4,000 if any portion of such area is located within a metropolitan statistical area (within the meaning of section 103A (1)(4)(B)) with a population of 50,000 or greater, or

"(II) 2,500 in any other case, or

"(ii) is entirely within an Indian reservation (as determined by the Secretary of the Interior), and

"(D) the area meets the requirements of paragraphs (2) and (3).

"(2) ELIGIBILITY REQUIREMENTS.—For purposes of paragraph (1), an area meets the requirements of this paragraph if the Secretary of Housing and Urban Development determines that—

"(A) the area is one of pervasive poverty, unemployment, and general distress, and

"(B) the area is located wholly within an area which meets the requirements for Federal assistance under section 119 of the Housing and

Community Development Act of 1974, as in effect on the date of enactment.

“(3) UNEMPLOYMENT, POVERTY, ETC. REQUIREMENTS.—An area meets the requirements of this paragraph if—

“(A) the annual average unemployment, as determined by the most recently available data from the Bureau of Labor Statistics, was at least 1½ times the national average for that period,

“(B) the area has a poverty rate of 20 percent or more for each census tract, minor civil division or census county division as determined by the most recently available census data,

“(C) at least 70 percent of the households living in the area have incomes below 80 percent of the median income of households of the local government (determined in the same manner as under section 119(b)(2) of the Housing and Community Development Act of 1974); or

“(D) the population of such area decreased by 20 percent or more between 1970 and 1980, as derived from census data.

“(d) REQUIRED STATE AND LOCAL COMMITMENTS.—

“(1) IN GENERAL.—No area shall be designated as an enterprise zone unless the local government and the State in which it is located agree in writing that during any period during which the area is an enterprise zone, such governments will follow a course of action designed to reduce the various burdens borne by employers or employees in such area.

"(2) COURSE OF ACTION.—A course of action under paragraph (1) may be implemented by both such governments and private nongovernmental entities, may be funded from proceeds of any Federal program, and may include, but is not limited to—

"(A) a reduction of tax rates or fees applying within the enterprise zone,

"(B) an increase in the level or efficiency of local services within the enterprise zone (particularly through experimentation with providing such services by nongovernmental entities),

"(C) actions to reduce, remove, simplify, or streamline governmental requirements applying within the enterprise zone, and

"(D) involvement in the program by private entities, organizations, neighborhood associations, and community groups, particularly those within the nominated zone area, including a commitment from such private entities to provide jobs and job training for, and technical, financial, or other assistance to, employers, employees, and residents of the nominated zone area.

"(e) PRIORITY OF DESIGNATION.—In choosing nominated zones for designation, the Secretary of Housing and Urban Development shall give special preference to those zones with respect to which the strongest and highest quality contributions described in subsection (d) have been promised as part of the course of action, taking into consideration the fiscal ability of the nominating State and local governments to provide tax relief. The Secretary shall also give preference to—

"(1) those nominated zones with respect to which the strongest and highest quality contributions other than those described in subsection (d) have been promised as part of the course of action,

"(2) those nominated zones with respect to which the most effective and enforceable guarantees have been provided by the nominating State and local governments that their proposed course of action will actually be carried out for the duration of the enterprise zone designation,

"(3) those nominated zones with high levels of poverty, unemployment, and general distress, particularly those in proximity to concentrations of disadvantaged workers or long-term unemployed individuals and with strong likelihood that zone residents who satisfy these criteria will receive jobs in the zone,

"(4) those nominated zones whose size and location will stimulate primarily new economic activity and minimize unnecessary tax losses to the Federal Government,

"(5) those nominated zones with respect to which private entities have made the most substantial commitments in additional resources and contributions, including the creation of new or expanded business activities, and

"(6) those nominated zones which best exhibit such other factors to be determined by the Secretary of Housing and Urban Development, as are—

"(A) consistent with the intent of the enterprise zone program, and

"(B) important to minimizing the unnecessary loss of tax revenues to the Federal Government.

"(f) DEFINITIONS AND SPECIAL RULE.—For purposes of this section—

"(1) GOVERNMENTS.—If more than one government seeks to nominate an area as an enterprise zone, any reference to, or requirement of this section shall apply to all such governments.

"(2) STATES.—For purposes of this section, the term 'State' shall include the District of Columbia, Puerto Rico, the Virgin Islands, Guam, American Samoa, the Northern Mariana Islands and the possessions of the United States.

"(3) LOCAL GOVERNMENT.—For purposes of this section, the term 'local government' shall include the city, town, township, parish, village, or other form of municipal government when the nominated zone is within an incorporated area, and the county government when the nominated zone is within an unincorporated area."

(b) CONFORMING AMENDMENT.—The table of subchapters for chapter 80 is amended by adding at the end thereof the following new item:

"Subchapter C—Designation of Enterprise Zones".

SEC. 102. INTERACTION WITH OTHER FEDERAL PROGRAMS.

(a) PROPERTY TAX REDUCTIONS.—Any reduction of taxes under any required program of local commitment under section 7871(d) of the Internal Revenue Code of 1954 shall be disregarded in determining the eligibility of a State or local government for, or the amount or extent of, any assistance or benefits under any law of the United States.

(b) Designation of an enterprise zone under section 7871 shall not constitute approval of a Federal or federally assisted program or project as those terms are used in the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (42 U.S.C. 4601), and no person displaced from real property located in an enterprise zone designated under such section shall have any rights or be entitled to any benefit pursuant to the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 as a result of such designation.

TITLE II—FEDERAL INCOME TAX INCENTIVES

Subtitle A—Credits for Employers and Employees

SEC. 201. CREDITS FOR ENTERPRISE ZONE EMPLOYERS.

(a) CREDIT FOR INCREASED ENTERPRISE ZONE EMPLOYMENT.—Subpart A of part IV of subchapter A of chapter 1 (relating to credits allowable) is amended by inserting immediately before section 45 the following new sections:

"SEC. 44H. CREDIT FOR INCREASED ENTERPRISE ZONE EMPLOYMENT.

"(a) IN GENERAL.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 10 percent of the qualified increased employment expenditures of the taxpayer for the taxable year.

"(b) QUALIFIED INCREASED EMPLOYMENT EXPENDITURES DEFINED.—For purposes of this section, the term 'qualified increased employment expenditures' means the amount by which qualified wages paid or incurred by the employer during the taxable year to qualified employees exceeds the base period wages.

"(c) QUALIFIED WAGES DEFINED.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the term 'qualified wages' has the meaning given to the term 'wages' by subsection (b) of section 3306, in an amount which does not exceed 2½ times the dollar limitation contained in such section for any employee.

"(2) REDUCTION FOR CERTAIN AMOUNTS.—For purposes of this section, the wages paid or incurred by an employer shall not include—

"(A) the amount of any federally funded payments the employer receives or is entitled to receive for on-the-job training of such individual for such period, or

"(B) any amount claimed as a credit under section 44I with respect to such period.

"(d) QUALIFIED EMPLOYEE DEFINED.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified employee' means an individual—

"(A) at least 90 percent of whose services for the taxpayer during the taxable year are directly related to the conduct of the taxpayer's trade or business located in an enterprise zone, and

"(B) who performs at least 50 percent of his services for the taxpayer during the taxable year in an enterprise zone.

"(2) EXCEPTIONS.—The term 'qualified employee' shall not include an individual with respect to whom the employer claims any credit under section 40 (relating to expenses of work incentives programs) or 44B (relating to credit for employment of certain new employees) for such period.

"(e) BASE PERIOD WAGES DEFINED.—For purposes of this section, the term 'base period wages' means wages paid during the 12-calendar month period ending prior to the enterprise zone designation under section 7871, which would have been qualified wages had such designation been in effect for such period. Base period wages will be zero for any employer not engaged in an active trade or business in such area at any time during such 12-month period.

"(f) LIMITATIONS.—

"(1) SUBCHAPTER S CORPORATIONS.—In case of an electing small business corporation (as defined in section 1371)—

"(A) the qualified wages for each taxable year shall be apportioned pro rata among the persons who are shareholders of such corporation on the last day of such taxable year, and

"(B) any person to whom any qualified wages have been apportioned under subparagraph (A) shall be treated (for purposes of this subpart) as the employer with respect to such expenses.

"(2) ESTATES AND TRUSTS.—In the case of an estate or trust—

"(A) the qualified wages for any taxable year shall be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each, and

"(B) any beneficiary to whom any qualified wages have been apportioned under subparagraph (A) shall be treated (for purposes of this subpart) as the employer with respect to such wages.

"(3) LIMITATIONS WITH RESPECT TO CERTAIN PERSONS.—In the case of—

"(A) an organization to which section 593 applies, "(B) a regulated investment company or a real estate investment trust subject to taxation under subchapter M (section 851 and following), and

"(C) a cooperative organization described in section 1381(a),

rules similar to the rules provided in subsections (e) and (h) of section 46 shall apply under regulations prescribed by the Secretary.

"(g) PHASEOUT OF CREDIT.—The credit specified in subsection (a) will be reduced to 7½ percent in the taxable year of the taxpayer in which the 21st anniversary of the enterprise zone designation under section 7871 falls, 5 percent in the next subsequent taxable year, 2½ percent in the second subsequent taxable year, and zero thereafter.

"(h) ADJUSTMENTS FOR CERTAIN ACQUISITIONS, ETC.—Under regulations prescribed by the Secretary—

"(1) ACQUISITIONS.—If an employer acquires the major portion of a trade or business of another person (hereinafter in this paragraph referred to as the 'predecessor') or the major portion of a separate unit of a trade or business of a predecessor, then, for purposes of applying this subpart for any calendar year ending after such acquisition, the amount of qualified wages and base period wages deemed paid by the employer during periods before such acquisition shall be increased by so much of such wages paid by the predecessor with respect to the acquired trade or business as is attributable to the portion of such trade or business acquired by the employer.

"(2) DISPOSITIONS.—

"(A) If an employer disposes of the major portion of any trade or business of the employer or the major portion of a separate unit of a trade or business of the employer in a transaction to which paragraph (1) applies, and

"(B) the employer furnishes the acquiring person such information as is necessary for the application of paragraph (1),

then, for purposes of applying this subpart for any calendar year ending after such disposition, the amount of qualified wages or base period wages deemed paid by the employer during periods before such disposition shall be decreased by so much of such wages as is attributable to such trade or business or separate unit.

"(i) SPECIAL RULES FOR CONTROLLED GROUPS.—

"(1) CONTROLLED GROUP OF CORPORATIONS.— For purposes of this section, all employees of all corporations which are members of the same controlled group of corporations shall be treated as employed by a single employer. In any such case, the credit (if any) allowable by section 44H to each such member shall be determined by reference to its proportionate share of the qualified wages giving rise to such credit. For purposes of this subsection, the term 'controlled group of corporations' has the meaning given to such term by section 1563(a), except that—

"(A) 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears in section 1563(a)(1), and

"(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.

"(2) EMPLOYEES OF PARTNERSHIPS, PROPRIETORSHIPS, ETC., WHICH ARE UNDER COMMON CONTROL.—For purposes of this section, under regulations prescribed by the Secretary—

"(A) all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer, and

"(B) the credit (if any) allowable by section 44H with respect to each trade or business shall be determined by reference to its proportionate share of the qualified wages giving rise to such credit.

The regulations prescribed under this paragraph shall be based on principles similar to the principles which apply in the case of paragraph (1).

"(j) PERIODS OF LESS THAN A YEAR.—If designation of an area as an enterprise zone under section 7871 occurs, expires, or is revoked on a date other than the first or last day of the taxable year of the taxpayer, or in the case of a short taxable year—

"(1) the limitation specified in subsection (c)(1), and the base period wages determined under subsection (e), shall be adjusted on a pro rata basis (based upon the number of days), and

"(2) the reduction specified in subsection (c)(2) and the 50 percent test set forth in subsection (d)(1), shall be determined by reference to the portion of the taxable year during which the designation of the area as an enterprise zone is effective.

"(k) APPLICATION WITH OTHER CREDITS.—The credit allowed by subsection (a) for a taxable year shall not exceed the tax imposed by this chapter for such taxable year, reduced by the sum of the credits allowable under section 44I or any section of this subpart having a lower number or letter designation than this section, other than the credits allowable by sections 31, 39, and 43. For purposes of the preceding sentence, the term 'tax imposed by this chapter' shall not include any tax treated as not imposed by this chapter under the last sentence of section 53(a).

"(l) ENTERPRISE ZONE.—The term 'enterprise zone' means an area for which designation as an enterprise zone is in effect under section 7871.

"SEC. 44I.—CREDIT FOR EMPLOYMENT OF CERTAIN DISADVANTAGED INDIVIDUALS IN AN ENTERPRISE ZONES.

"(a) IN GENERAL.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of—

"(1) 50 percent of qualified years one-three wages,

"(2) 40 percent of qualified year four wages,

"(3) 30 percent of qualified year five wages,

"(4) 20 percent of qualified year six wages, and

"(5) 10 percent of qualified year seven wages.

"(b) QUALIFIED WAGES DEFINED.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified wages' means the wages paid or incurred by the employer during taxable year to qualified disadvantaged individuals reduced by the amount of any federally funded payments the employer receives or is entitled to receive for on-the-job training of such individuals for such period.

"(2) QUALIFIED YEARS ONE–THREE WAGES.—The term 'qualified years one–three wages' means, with respect to any individual, qualified wages received during the 36-month period beginning with the day the individual begins work for the employer within an enterprise zone (or, in the case of a vocational rehabilitation referral, the day the individual begins work for an employer within an enterprise zone on or after the beginning of such individual's rehabilitation plan).

"(3) QUALIFIED YEAR FOUR WAGES.—The term 'qualified year four wages' means, with respect to any individual, the qualified wages attributable to services rendered during the 12-month period beginning on the day after the last day of the period with respect to such individual determined under paragraph (2).

"(4) QUALIFIED YEAR FIVE WAGES.—The term 'qualified year five wages' means, with respect to any individual, the qualified wages attributable to services rendered during the 12-month period beginning on the day after the last day of the period with respect to such individual determined under paragraph (3).

"(5) QUALIFIED YEAR SIX WAGES.—The term 'qualified year six wages' means, with respect to any individual, the qualified wages attributable to services rendered during the 12-month period beginning on the day after the last day of the period with respect to such individual determined under paragraph (4).

"(6) QUALIFIED YEAR SEVEN WAGES.—The term 'qualified year seven wages' means, with respect to any individual, the qualified wages attributable to services rendered during the 12-month period beginning on the day after the last day of the period with respect to such individual determined under paragraph (5).

"(7) BREAKS IN SERVICE.—With respect to any individual, the time periods described in paragraphs (3) through (6) will not take into account any period of time during which such individual is unemployed.

"(c) QUALIFIED DISADVANTAGED INDIVIDUAL.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified disadvantaged individual' means an individual—

"(A) who is a qualified employee within the meaning of section 44H(d),

"(B) who is hired by the employer after the designation of the area in which services were performed as an enterprise zone (under section 7871), and

"(C) who is described in paragraph (2).

"(2) CATEGORIES OF DISADVANTAGED INDIVIDUALS.—For purposes of paragraph (1), the following individuals are treated as disadvantaged individuals:

"(A) a vocational rehabilitation referral,

"(B) an economically disadvantaged individual,

"(C) an eligible foster child,

"(D) an SSI recipient,

"(E) a general assistance recipient,

"(F) an eligible handicapped individual, or

"(G) an eligible AFDC recipient.

"(3) VOCATIONAL REHABILITATION REFERRAL.—The term 'vocational rehabilitation referral' means any individual who is certified by the designated local agency as—

"(A) having a physical or mental disability which, for such individual, constitutes or results in a substantial handicap to employment, and

"(B) having been referred to the employer upon completion of (or while receiving) rehabilitative services pursuant to—

"(i) an individualized written rehabilitation plan under a State plan for vocational rehabilitation services approved under the Rehabilitation Act of 1973, or "(ii) a program of vocational rehabilitation carried out under chapter 31 of title 38, United States Code.

"(4) ECONOMICALLY DISADVANTAGED INDIVIDUAL.—The term 'economically disadvantaged individual' means any individual who is certified by the designated local agency as being a member of a family that had an income during the 6 months preceding the month in which such determination occurs that, on an annual basis, was equal to or less than that which an eligible family with no income would have received in food stamps plus AFDC benefits. Any such determination shall be valid for the 45-day period beginning on the date such determination is made.

"(5) FOSTER CHILDREN.—The term 'eligible foster child' means any individual who is certified by the designated local agency as receiving State or local government benefits under a program to assist foster children.

"(6) SSI RECIPIENTS.—The term 'SSI recipient' means any individual who is certified by the designated local agency as receiving supplemental security income benefits under title XVI of the Social Security Act (including supplemental security income benefits of the type described in section 1616 of such Act or section

212 of Public Law 93-66) for any month ending in the preemployment period, or who would have qualified to receive such benefits had such individual applied for them.

"(7) GENERAL ASSISTANCE RECIPIENTS.—

"(A) IN GENERAL.—The term 'general assistance recipient' means any individual who is certified by the designated local agency as receiving assistance under a qualified general assistance program for any period of not less than 30 days ending within the preemployment period, or who would have qualified to receive such assistance had such individual applied for it.

"(B) QUALIFIED GENERAL ASSISTANCE PROGRAM.—The term 'qualified general assistance program' means any program of a State or a political subdivision of a State—

"(i) which provides general assistance or similar assistance which—

"(I) is based on need, and

"(II) consists of money payments, and

"(ii) which is designated by the Secretary (after consultation with the Secretary of

Health and Human Services) as meeting the requirements of clause (i).

"(8) HANDICAPPED INDIVIDUALS.—In cases permitted by regulations prescribed by the Secretary, the term 'eligible handicapped individual' means any individual who is certified by the designated local agency—

"(A) as disabled and living at home, or

"(B) who is institutionalized or receiving services in, or is a client of, a sheltered workshop, prison, hospital or similar institution, or in community care.

"(9) ELIGIBLE AFDC RECIPIENTS.—The term 'eligible AFDC recipient' means an individual who has been certified by the designated local agency as being eligible for financial assistance under part A of title IV of the Social Security Act and as having continually received such financial assistance during the 90-day period which immediately precedes the date on which such individual is hired by the employer, or who would have received such assistance had such individual applied for it.

"(10) PREEMPLOYMENT PERIOD.—The term 'preemployment period' means the 60-day period ending on the hiring date.

"(11) HIRING DATE.—The term 'hiring date' means the day the individual is hired by the employer.

"(12) DESIGNATED LOCAL AGENCY.—The term 'designated local agency' means a State employment security agency established in accordance with the Act of June 6, 1933, as amended (29 U.S.C. 49–49n).

"(13) SPECIAL RULES FOR CERTIFICATIONS.—

"(A) IN GENERAL.—An individual shall not be treated as a qualified disadvantaged individual unless, on or before the day on which such individual begins work for the employer, the employer—

"(i) has received a certification from a designated local agency that such individual is a qualified disadvantaged individual, or

"(ii) has requested in writing such certification from the designated local agency.

"(B) INCORRECT CERTIFICATIONS.—If—

"(i) an individual has been certified as a qualified disadvantaged individual, and

"(ii) such certification is incorrect because it was based on false information provided by such individual, the certification shall be revoked and wages paid by the employer after the date on which notice of revocation is received by the employer shall not be treated as qualified wages.

"(d) SPECIAL RULES.—

"(1) CONTROLLED GROUP OF CORPORATIONS.—For purposes of this section, all employees of all corporations which are members of the same controlled group of corporations shall be treated as employed by a single employer. In any such case, the credit (if any) allowable by section 44I to each such member shall be determined by reference to its proportionate share of the qualified wages giving rise to such credit. For purposes of this subsection, the term 'controlled group of corporations' has the meaning given to such term by section 1563(a), except that—

"(A) 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears in section 1563(a)(1), and

"(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.

"(2) EMPLOYEES OF PARTNERSHIPS, PROPRIETORSHIPS, ETC., WHICH ARE UNDER COMMON CONTROL.—For purposes of this section, under regulations prescribed by the Secretary—

"(A) all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer, and

"(B) the credit (if any) allowable by section 44I with respect to each trade or business shall be determined by reference to its proportionate share of the qualified wages giving rise to such credit.

The regulations prescribed under this paragraph shall be based on principles similar to the principles which apply in the case of paragraph (1).

"(3) ACQUISITIONS.—Under regulations prescribed by the Secretary, if an employer acquires of the major portion of a trade or business of another employer (hereinafter in this paragraph referred to as the 'predecessor') or the major portion of a separate unit of a trade or business of a predecessor, then, for purposes of applying this section (other than subsection (e)) for any calendar year ending after such acquisition, the employment relationship between an employee and an employer shall not be treated as terminated if the employee continues to be employed in such trade or business.

"(e) EARLY TERMINATION OF EMPLOYMENT BY EMPLOYER, ETC.—

"(1) GENERAL RULE.—Under regulations prescribed by the Secretary, if the employment of any employee with respect to whom qualified wages are taken into account under subsection (a) is terminated by the taxpayer at any time during the first 270 days of such employment (whether or not consecutive) or before the close of the 270th calendar day after the day in which such employee completes 90 days of employment with the taxpayer, the tax under this chapter for the taxable year in which such employment is terminated shall be increased by an amount (determined under such regulations) equal to the credit allowed under subsection (a) for such taxable year and all prior taxable years attributable to qualified wages paid or incurred with respect to such employee.

"(2) SUBSECTION NOT TO APPLY IN CERTAIN CASES.—

"(A) IN GENERAL.—Paragraph (1) shall not apply to—

"(i) a termination of employment of an employee who voluntarily leaves the employment of the taxpayer, "(ii) a termination of employment of an individual who, before the close of the period referred to in paragraph (1), becomes disabled to perform the services of such employment, unless such disability is removed before the close of such period and the taxpayer fails to offer reemployment to such individual,

"(iii) a termination of employment of an individual, if it is determined under the applicable State unemployment compensation law that the termination was due to the misconduct of such individual, or

"(iv) a termination of employment of an individual due to a substantial reduction in the trade or business operations of the taxpayer.

"(B) CHANGE IN FORM OF BUSINESS, ETC.—For purposes of paragraph (1), the employment relationship between the taxpayer and an employee shall not be treated as terminated—

"(i) by a transaction to which section 381(a) applies, if the employee continues to be employed by the acquiring corporation, or "(ii) by reason of a mere change in the form of conducting the trade or business of the taxpayer, if the employee continues to be employed in such trade or business and the taxpayer retains a substantial interest in such trade or business.

"(3) SPECIAL RULE.—Any increase in tax under paragraph (1) shall not be treated as tax imposed by this chapter for purposes of determining the amount of any credit allowable under subpart A.

"(f) LIMITATIONS.—

"(1) SUBCHAPTER S CORPORATIONS.—In the case of an electing small business corporation (as defined in section 1371)—

"(A) the qualified wages for each taxable year shall be apportioned pro rata among the persons who are shareholders of such corporation on the last day of such taxable year, and

"(B) any person to whom any qualified wages have been apportioned under subparagraph (A) shall be treated (for purposes of this subpart) as the employer with respect to such expenses.

"(2) ESTATES AND TRUSTS.—In the case of an estate or trust—

"(A) the qualified wages for any taxable year shall be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each, and

"(B) any beneficiary to whom any qualified wages have been apportioned under subparagraph (A) shall be treated (for purposes of this subpart) as the employer with respect to such wages.

"(3) LIMITATIONS WITH RESPECT TO CERTAIN PERSONS.—In the case of—

"(A) an organization to which section 593 applies,

"(B) a regulated investment company or a real estate investment trust subject to taxation under subchapter M (section 851 and following), and

"(C) a cooperative organization described in section 1381(a),

rules similar to the rules provided in subsections (e) and (h) of section 46 shall apply under regulations prescribed by the Secretary.

"(g) PHASEOUT OF CREDIT.—The credit specified in subsection (a) will be reduced by 25 percent in the taxable year of the taxpayer in which the 21st anniversary of the enterprise zone designation under section 7871 falls, 50 percent in the next subsequent taxable year, 75 percent in the second subsequent taxable year, and 100 percent thereafter.

"(h) Application With Other Credits.—The credit allowed by subsection (a) for a taxable year shall not exceed the tax imposed by this chapter for such taxable year, reduced by the sum of the credits allowable under a section of this subpart having a lower number or letter designation than this section, other than the credits allowable by sections 31, 39, 43, and 44H. For purposes of the preceding sentence, the term 'tax imposed by this chapter' shall not include any tax treated as not imposed by this chapter under the last sentence of section 53(a).

"(i) Enterprise Zone.—The term 'enterprise zone' means an area for which designation as an enterprise zone is in effect under section 7871.".

(b) No Deduction Allowed.—

(1) In general.—Section 280C (relating to disallowance of deductions for that portion of wages for which credit is claimed under section 40 or 44B) is amended—

(A) by adding at the end thereof the following new subsection:

"(c) Rule for Section 44H and 44I Credits.—No deduction shall be allowed for that portion of the wages or salaries paid or incurred for the taxable year which is equal to the amount of the credit allowable under section 44H (relating to the employment credit for enterprise zone businesses) and section 44I (relating to the credit for employment of certain disadvantaged individuals in enterprise zones). This subsection shall be applied under a rule similar to the rule under the last sentence of subsection (b).''; and

(B) by striking out "or 44B" in the heading and inserting in lieu thereof ", 44B, 44H or 44I".

(2) CONFORMING AMENDMENT.—The table of sections for part IX of subchapter B of chapter 1 is amended by striking out "or 44B." in the item relating to section 280C and inserting in lieu thereof ", 44B, 44H, or 44I".

(c) CONFORMING AMENDMENT.—The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by inserting before the item relating to section 45 the following new items:

"Sec. 44H. Credit for increased enterprise zone employment.
"Sec. 44I. Credit for employment of certain disadvantaged individuals in enterprise zones."

(d)(1) REPORTING REQUIREMENTS.—Subpart C of part III of subchapter A of chapter 61 (relating to information regarding wages paid employees) is amended by adding at the end thereof the following new section:

"SEC. 6054. REPORTING OF ENTERPRISE ZONE EMPLOYEE CREDITS.—If any individual is a qualified employee of an employer within the meaning of section 44H(d)(1), the employer shall furnish to each such employee a written statement showing the amount of wages paid to such employee. The statement required to be furnished pursuant to this section shall be furnished at such time, shall contain such other information, and shall be in such form as the Secretary may by regulations prescribe. When required by such regulations, a duplicate of any such statement shall be filed with the Secretary.".

(2) Section 6652(d) (relating to failure to file information returns) is amended by inserting after "respect to tips)," the following: "section 6054 (relating to reporting of enterprise zone employee credits),".

(3) Section 6674 (relating to fraudulent statement or failure to furnish statement to employee) is amended by striking "or 6053(b)" each place it appears and inserting in lieu thereof ", 6053(b) or 6054".

(4) The table of sections for such subpart C is amended by adding at the end thereof the following:

"Sec. 6054. Reporting of enterprise zone employee credits.".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to wages paid after the date of the enactment of this Act in taxable years ending after such date.

SEC. 202. CREDIT FOR ENTERPRISE ZONE EMPLOYEES.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 (relating to credits allowable), as amended by section 201, is amended by inserting immediately before section 45 the following new section:

"SEC. 44J. CREDIT FOR ENTERPRISE ZONE EMPLOYEES.

"(a) IN GENERAL.—In the case of a qualified employee, there is allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 5 percent of the qualified wages for the taxable year.

"(b) DEFINITIONS.—For purposes of this section—

"(1) QUALIFIED EMPLOYEE.—The term 'qualified employee' means an individual—

"(A) who is described in section 44H(d)(1), and

"(B) who is not the employee of the Federal Government or any State or subdivision of a State.

"(2) QUALIFIED WAGES.—

"(A) IN GENERAL.—The term 'qualified wages' has the meaning given to the term 'wages' under subsection (b) of section 3306, attributable to services performed for an employer with respect to whom the employee is a qualified employee, in an amount which does not exceed 1½ times the dollar limitation specified in such subsection.

"(B) EXCEPTION.—The term 'qualified wages' does not include any compensation received from the Federal Government or any State or subdivision of a State.

"(3) ENTERPRISE ZONE.—The term 'enterprise zone' means any area with respect to which a designation as an enterprise zone is in effect under section 7871.

"(c) PHASEOUT OF CREDIT.—The credit specified in subsection (a) will be reduced to 3¾ percent in the taxable year in which the 21st anniversary of enterprise zone designation under section 7871 falls, 2½ percent in the next subsequent taxable year, 1¼ percent in the second subsequent taxable year, and zero thereafter.

"(d) APPLICATION WITH OTHER CREDITS.—The credit allowed by subsection (a) for a taxable year shall not exceed the tax imposed by this chapter for such taxable year, reduced by the sum of the credits allowable under a section of this subpart having a lower number or letter designation than this section, other than the credits allowable by sections 31, 39, and 43. For purposes of the preceding sentence, the term 'tax imposed by this chapter' shall not include any tax treated as not imposed by this chapter under the last sentence of section 53(a).".

(b) CONFORMING AMENDMENT.—The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by inserting immediately before the item relating to section 45 the following new item:

"Sec. 44J. Credit for Enterprise Zone Employees.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

Subtitle B—Credits for Investment in Tangible Property in Enterprise Zones

SEC. 211. INVESTMENT TAX CREDIT FOR ENTERPRISE ZONE PROPERTY.

(a) SECTION 38 PROPERTY.—Paragraph (1) of section 48(a) (defining section 38 property) is amended by striking out the period at the end of subparagraph (G) and by inserting in lieu thereof "; or" and the following new subparagraph:

"(H) in the case of enterprise zone property, that portion of the basis which is attributable to qualified enterprise zone expenditures (within the meaning of subsection (q)).".

(b) AMOUNT OF CREDIT.—

(1) IN GENERAL.—Subparagraph (A) of section 46(a)(2) (relating to amount of investment tax credit) is amended by striking out "and" at the end of clause

(iii), by striking out the period at the end of clause (iv), by inserting in lieu thereof ", and", and by adding at the end thereof the following new clause:

"(v) in the case of qualified enterprise zone property, the enterprise zone percentage.".

(2) ENTERPRISE ZONE PERCENTAGE DEFINED.—Paragraph (2) of section 46(a) is amended by adding at the end thereof the following new subparagraph:

"(G) ENTERPRISE ZONE PERCENTAGE.—For purposes of this paragraph—

"In the case of qualified enterprise zone expenditures with respect to:	The enterprise zone percentage is:
Zone personal property (within the meaning of section 48(q)(2))	5
New zone construction property (within the meaning of section 48(q)(3))	10.".

(3) ORDERING RULES.—That portion of paragraph (9) of section 46(a)(9) (relating to special rules in the case of energy property) which precedes subparagraph (B) is amended to read as follows:

"(9) SPECIAL RULES IN THE CASE OF ENERGY PROPERTY OR ENTERPRISE ZONE PROPERTY.—Under regulations prescribed by the Secretary—

"(A) IN GENERAL.—This subsection and subsection (b) shall be applied separately—

"(i) first with respect to so much of the credit allowed by section 38 as is not attributable to the energy percentage or the enterprise zone percentage,

"(ii) second with respect to so much of the credit allowed by section 38 as is attributable to the application of the energy percentage to energy property, and

"(iii) third with respect to so mch of the credit allowed by section 38 as is attributable to the application of the enterprise zone percentage to enterprise zone property.".

(4) CONFORMING AMENDMENT.—Section 48(o) (defining certain credits) is amended by adding at the end thereof the following new paragraph:

"(9) ENTERPRISE ZONE CREDIT.—The term 'enterprise zone credit' means that portion of the credit allowable by section 38 which is attributable to the enterprise zone percentage.".

(c) DEFINITIONS AND TRANSITIONAL RULES.—Section 48 (relating to definitions and special rules) is amended by redesignating subsection (q) as (r) and inserting after subsection (p) the following new subsection:

"(q) ENTERPRISE ZONE PROPERTY.—

"(1) The term 'enterprise zone property' means property which is—

"(A)(i) zone personal property, or

"(ii) new zone construction property,

"(B) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer (within the meaning of section 267(b) or 318), and

"(C) acquired and first placed in service by the taxpayer in an enterprise zone after the designation under section 7871.

"(2) ZONE PERSONAL PROPERTY DEFINED.—The term 'zone personal property' means section 38 property which is—

"(A) 3-year property, within the meaning of section 168(c)(2)(A);

"(B) 5-year property, within the meaning of section 168(c)(2)(B);

"(C) 10-year property, within the meaning of section 168(c)(2)(C); and

"(D) 15-year public utility property, within the meaning of section 168(c)(2)(E),

which is used by the taxpayer predominantly in the active conduct of a trade or business within an enterprise zone. Property shall not be treated as 'zone personal property' if it is used or located outside the enterprise zone on any regular basis.

"(3) NEW ZONE CONSTRUCTION PROPERTY DEFINED.—The term 'new zone construction property' means 15-year property described in section 168(c)(2)(D), which is—

"(A) located in an enterprise zone,

"(B) used by the taxpayer predominantly in the active conduct of a trade or business within an enterprise zone, and

"(C) either—

"(i) the construction, reconstruction, rehabilitation, renovation, expansion, or erection of which is completed by the taxpayer after the designation under section 7871, or

"(ii) acquired after such designation if the original use of such property commences with the taxpayer and commences after such date.

In applying section 46(c)(1)(A) in the case of property described in clause (i), there shall be taken into account only that portion of the basis which is properly attributable to construction or erection after designation.

"(4) ADJUSTMENT TO BASIS.—

"(A) IN GENERAL.—For purposes of this subtitle, if an enterprise zone credit is allowable under this section for any qualified enterprise zone expenditure in connection with property described in paragraph (3), the increase in basis of such property which would (but for this paragraph) result from such expenditure shall be reduced by the amount of the credit so allowable.

"(B) CERTAIN DISPOSITIONS.—If during any taxable year there is a recapture amount determined with respect to any enterprise zone property the basis of which was reduced under subparagraph (A), the basis of such building (immediately before the event resulting in such recapture) shall be increased by an amount equal to such recapture amount. For purposes of the preceding sentence, the term 'recapture amount' means any increase in tax (or adjustment in carrybacks or carryovers) determined under section 47(a)(2)(A)(v).

"(5) QUALIFIED ENTERPRISE ZONE EXPENDITURES DEFINED.—The term 'qualified enterprise zone expenditures' means any amount properly chargeable to capital account for enterprise zone property.

"(6) REAL ESTATE RENTAL.—For purposes of this section, ownership of residential, commercial or industrial real property within an enterprise zone for rental shall be treated as the active conduct of a trade or business in an enterprise zone.

"(7) ENTERPRISE ZONE.—The 'enterprise zone' means an area for which designation as an enterprise zone is in effect under section 7871.".

"(d) LODGING TO QUALIFY.—Paragraph (3) of section 48(a) (relating to property used for lodging) is amended—

(1) by striking out "and" at the end of subparagraph (C),

(2) by striking out the period at the end of subparagraph (D) and inserting in lieu thereof "and", and

(3) by adding at the end thereof the following new subparagraph:

"(E) new zone construction property.".

(e) RECAPTURE.—Subsection (a) of section 47 (relating to certain dispositions, etc., of section 38 property) is amended by adding at the end thereof the following new paragraph:

"(9) SPECIAL RULES FOR ENTERPRISE ZONE PROPERTY.—

"(A) If, during any taxable year, property with respect to which the taxpayer claimed an enterprise zone credit is disposed of, or in the case of zone personal property otherwise ceases to be section 38 property with respect to the taxpayer, or is removed from the enterprise zone, converted or otherwise ceases to be enterprise zone property (other than by the expiration or revocation of the designation as an enterprise zone), the tax under this chapter for such taxable year shall be increased by the amount described in subparagraph (ii).

"(B) The increase in tax under subparagraph (A) shall equal the aggregate decrease in the credits allowed under section 38 by reason of section 46(a)(2)(A)(v) for all prior taxable years which would have resulted solely from reducing the qualified enterprise zone expenditures taken into account with respect to the property by an amount which bears the same ratio to the qualified enterprise zone expenditures as the number of taxable years that the property was held by the taxpayer bears to the applicable recovery period for earnings and profits as set forth in section 312(k).".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to expenditures made or incurred after enactment, in taxable years ending after such date, with respect to property acquired and placed in service in an area designated as an enterprise zone under section 7871.

Subtitle C—Reduction in Capital Gain Tax Rates

SEC. 221. CORPORATIONS.

(a) GENERAL RULE.—Subsection (a) of section 1201 (relating to alternative tax for corporations) is amended by striking out paragraph (2) and inserting in lieu thereof the following:

"(2) a tax of 28 percent of the excess (if any) of—

"(A) the net capital gain for the taxable year, over

"(B) the qualified enterprise zone capital gain.".

(b) DEFINITION OF QUALIFIED ENTERPRISE ZONE CAPITAL GAIN.—Section 1201 is amended by redesignating subsections (b) and (c) as subsections (c) and (d) and by inserting after subsection (a) the following new subsection:

"(b) QUALIFIED ENTERPRISE ZONE CAPITAL GAIN.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified enterprise zone capital gain' means—

"(A) gain described in section 1222(3),

"(B) attributable to the sale or exchange of qualified property.

"(2) LIMITATIONS.—The term 'qualified enterprise zone capital gain' does not include any gain attributable to the sale or exchange of an interest in a qualified business to the extent attributable to—

"(A) any property contributed to the qualified business within the previous 12 months,

"(B) any interest in any business which is not a qualified business, or

"(C) any other intangible property not created as part of an active trade or business within an enterprise zone.

"(3) DEFINITIONS.—

"(A) The term 'qualified property' means—

"(i) any tangible personal property used by the taxpayer predominantly (within the meaning of section 48(q)(7)) in an enterprise zone in the active conduct of a trade or business in an enterprise zone,

"(ii) any real property located in an enterprise zone used by the taxpayer predominantly in the active conduct of a trade or business in an enterprise zone, and

"(iii) any interest in a corporation, partnership, or other entity if, for the three most recent taxable years of such entity ending before the date of disposition of such interest (or for such part of such period as the entity has been in existence or the zone has been designated), such entity was a qualified business.

"(B) QUALIFIED BUSINESS.—The term 'qualified business' means any person—

"(i) which is actively engaged in the conduct of a trade or business within an enterprise zone during the period described in subparagraph (A)(iii),

"(ii) with respect to which at least 80 percent of such person's gross receipts for the taxable year are attributable to the active conduct of a trade or business within an enterprise zone, and

"(iii) with substantially all of its tangible assets located within an enterprise zone.

"(C) REAL ESTATE RENTAL.—For purposes of this section, ownership of residential, commercial or industrial real property within an enterprise zone for rental shall be treated as the active conduct of a trade or business in an enterprise zone.

"(D) PROPERTY REMAINS QUALIFIED AFTER ZONE DESIGNATION CEASES TO APPLY.—

"(i) IN GENERAL.—The treatment of property as qualified property under subparagraph (A) shall not terminate when on the designation of the enterprise zone in which the property is located or used expires or is revoked.

"(ii) EXCEPTIONS.—Clause (i) shall not apply after the first sale or exchange of property occurring after the designation expires or is revoked.

"(E) ENTERPRISE ZONE.—The term 'enterprise zone' means an area with respect to which a designation as an enterprise zone is in effect under section 7871.".

SEC. 222. TAXPAYERS OTHER THAN CORPORATIONS.

Subsection (a) of section 1202 (relating to deduction for capital gains) is amended to read as follows:

"(a) DEDUCTION ALLOWED.—

"(1) IN GENERAL.—If for any taxable year a taxpayer other than a corporation has a net capital gain, there shall be allowed as a deduction from gross income an amount equal to the sum of—

"(A) 100 percent of the lesser of—

"(i) the net capital gain, or

"(ii) the qualified enterprise zone capital gain (as defined in section 1201(b), plus

"(B) 60 percent of the excess (if any) of—

"(i) the net capital gain, over

"(ii) the amount of the net capital gain taken into account under subparagraph (A).".

SEC. 223. MINIMUM TAX.

(a) Paragraph (9) of section 57(a) (relating to tax preference for capital gains) is amended by adding at the end thereof of the following new subparagraph:

"(E) For purposes of this paragraph, gain attributable to qualified enterprise zone capital gain (within the meaning of section 1201(b)) shall not be taken into account.".

(b) It is the sense of the Congress that if the minimum tax is modified or replaced, enterprise zone capital gain will be excluded in computing the minimum taxable income.

SEC. 224. EFFECTIVE DATE.

The amendments made by this subtitle shall apply to sales or exchanges after the date of enactment of this Act.

Subtitle D—Extension of Carryover Periods

SEC. 241. EXTENSION OF NET OPERATING LOSS CARRYOVER PERIOD.

(a) IN GENERAL.—Paragraph (1) of section 172(b) (relating to net operating loss carrybacks and carryovers) is amended by adding at the end thereof the following new subparagraph:

"(J) In the case of any taxpayer engaged in the conduct of an active trade or business within an enterprise zone for any taxable year, any net operating loss for such taxable year attributable to such business shall be a net operating loss carryover to each following taxable year that ends before the expiration or revocation of the designation of the area as an enterprise zone under section 7871 (or to each of the 15 years following the taxable year of loss, if longer).".

(b) TECHNICAL AMENDMENT.—Subparagraph (B) of section 172(b)(1) is amended by striking out "and (I)" and inserting in lieu thereof "(I), and (J)".

SEC. 242. EXTENSION OF CREDIT CARRYOVER PERIOD.

(a) IN GENERAL.—Paragraph (1) of section 46(b) (relating to carryback and carryover of unused credits) is amended by adding at the end thereof the following new subparagraph:

"(E) In the case of an unused credit which is a credit attributable to the enterprise zone percentage, section 44H (relating to the credit for increased enterprise zone employment) or section 44I (relating to the credit for employment of certain disadvantaged individuals in an enterprise zone), this paragraph shall be applied by substituting 'until the designation as an enterprise zone under section 7871 expires or is revoked (or 15 years, if longer)' for '15'.".

Subtitle E—Rules Relating to Industrial Development Bonds

SEC. 251. SMALL ISSUE INDUSTRIAL DEVELOPMENT BONDS.

Notwithstanding any subsequent amendments affecting obligations described in section 103(b)(6) of the Internal Revenue Code of 1954 (other than amendments to section 103(c) relating to arbitrage, or amendments relating to registration of such obligations), section 103(b)(6) as in effect on January 1, 1982, shall apply to obligations all or the major portion of the proceeds of which are to be used directly for any land or depreciable property which is located in an enterprise zone (within the meaning of section 7871 of the Internal Revenue Code of 1954). This section shall apply only with respect to obligations which are issued after the date an area is designated as an enterprise zone and before such designation terminates, provided the proceeds are used prior to the date the area ceases to be an enterprise zone.

Subtitle F—Sense of the Congress With Respect to Tax Simplification

SEC. 261. TAX SIMPLIFICATION.

It is the sense of the Congress that the Secretary of the Treasury should in every way possible simplify the administration and enforcement of any provision of the Internal Revenue Code of 1954 added to, or amended by, this Act.

TITLE III—REGULATORY FLEXIBILITY

SEC. 301. DEFINITION OF SMALL ENTITIES IN ENTERPRISE ZONES FOR PURPOSES OF ANALYSIS OF REGULATORY FUNCTIONS.

Section 601 of title 5, United States Code, is amended by—

(1) striking out "and" at the end of paragraph (5); and

(2) striking out paragraph (6) and inserting in lieu thereof the following:

"(6) the term 'small entity' means—

"(A) a small business, small organization or small governmental jurisdiction within the meaning of paragraphs (3), (4), and (5) of this section, respectively; and

"(B) any qualified business; any governments which designated and approved an area which has been designated as an enterprise zone (within the meaning of section 7871 of the Internal Revenue Code) to the extent any rule pertains to the carrying out of projects, activities or undertakings within such zone; and any not-for-profit enterprise carrying out a significant portion of its activities within such a zone; and

"(7) the term 'qualified business' means any person, corporation or other entity—

"(A) which is engaged in the active conduct of a trade or business within an enterprise zone (within the meaning of section 7871 of the Internal Revenue Code of 1954); and

"(B) for whom at least 50 percent of its employees are qualified employees (within the meaning of section 44H(d) of such Code).".

SEC. 302. WAIVER OR MODIFICATION OF AGENCY RULES IN ENTERPRISE ZONES.

(a) Chapter 6 of title 5, United States Code, is amended by redesignating sections 611 and 612 as sections 612 and 613, respectively, and inserting the following new section immediately after section 610:

"SEC. 611. WAIVER OR MODIFICATION OF AGENCY RULES IN ENTERPRISE ZONES.

"(a) Upon the written request of the governments which designated and approved an area which has been designated as an enterprise zone under section 7871 of the Internal Revenue Code of 1954, an agency is authorized, in order to further the job creation, community development, or economic revitalization objectives of the zone, to waive or modify all or part of any rule which it has authority to promulgate, as such rule pertains to the carrying out of projects, activities or undertakings within the zone.

"(b) Nothing in this section shall authorize an agency to waive or modify any rule adopted to carry out a statute or Executive order which prohibits, or the purpose of which is to protect, persons against discrimination on the basis of race, color, religion, sex, marital status, national origin, age, or handicap.

"(c) A request under subsection (a) shall specify the rule or rules to be waived or modified and the change proposed, and shall briefly describe why the change would promote the achievement of the job creation, community development or economic revitalization objectives of the enterprise zone. If a request is made to an agency other than the Department of Housing and Urban Development, the requesting governments shall send a copy of the request to the Secretary of

Housing and Urban Development at the time the request is made.

"(d) In considering a request, the agency shall weigh the extent to which the proposed change is likely to further job creation, community development or economic revitalization within the enterprise zone against the affect the change is likely to have on the underlying purposes of applicable statutes in the geographic area which would be affected by the change. The agency shall approve the request whenever it finds, in its discretion, that the public interest which the proposed change would serve in furthering such job creation, community development or economic revitalization outweighs the public interest which continuation of the rule unchanged would serve in furthering such underlying purposes. The agency shall not approve any request to waive or modify a rule if that waiver or modification would—

"(1) directly violate a statutory requirement (including any requirement of the Act of March 3, 1931 (46 Stat. 1494; 40 U.S.C. 276a–5) (commonly known as the Davis-Bacon Act) or of the Fair Labor Standards Act of 1938 (52 Stat. 1060; 29 U.S.C. 201 et seq.)); or

"(2) be likely to present a significant risk to the public health, including environmental health or safety, such as a rule with respect to occupational safety or health, or environmental pollution.

"(e) If a request is disapproved, the agency shall inform the requesting governments in writing of the reasons therefor and shall, to the maximum extent possible, work with such governments to develop an alternative, consistent with the standards contained in subsection (d).

"(f) Agencies shall discharge their responsibilities under this section in an expeditious manner, and shall make a determination on requests not later than 90 days after their receipt.

"(g) A waiver or modification of a rule under subsection (a) shall not be considered to be a rule, rulemaking, or regulation under chapter 5 of this title. To facilitate reaching its decision on any requested waiver or modification, the agency may seek the views of interested parties and, if these views are to be sought, determine how they should be obtained and to what extent, if any, they should be taken into account in considering the request. The agency shall publish a notice in the Federal Register stating any waiver or modification of a rule under this section.

"(h) In the event that an agency proposes to amend a rule for which a waiver or modification under this section is in effect, the agency shall not change the waiver or modification to impose additional requirements unless it determines, consistent with standards contained in subsection (d), that such action is necessary.

"(i) No waiver or modification of a rule under this section shall remain in effect for a longer period than the period for which the enterprise zone designation remains in effect for the area in which the waiver or modification applies.

"(j) For purposes of this section, the term 'rule' means (1) any rule as defined in section 511(4) of this title or (2) any rulemaking conducted on the record after opportunity for an agency hearing pursuant to sections 556 and 557 of this title.".

(b) The table of sections for such chapter is amended by redesignating "Sec. 611." and "Sec. 612." as "Sec. 612." and "Sec. 613.", respectively, and inserting the following new item immediately after "Sec. 610.":

"Sec. 611. Waiver or modification of agency rules in enterprise zones.".

(c) Section 601(2) of such title is amended by inserting "(except for purposes of section 611)" immediately before "means".

(d) Section 613 of such title as redesignated by subsection (a) of this section is amended by—

(1) inserting "(except section 611)" immediately after "chapter" in subsection (a); and

(2) inserting "as defined in section 601(2)" immediately before the period at the end of the first sentence of subsection (b).

SEC. 303. COORDINATION OF HOUSING AND URBAN DEPARTMENT PROGRAMS IN ENTERPRISE ZONES.

Section 3 of the Department of Housing and Urban Development Act is amended by adding at the end thereof the following new subsection:

"(d) The Secretary of Housing and Urban Development shall—

"(1) promote the coordination of all programs under his jurisdiction which are carried on within an enterprise zone designated pursuant to section 7871 of the Internal Revenue Code of 1954;

"(2) expedite, to the greatest extent possible, the consideration of applications for programs referred to in paragraph (1) through the consolidation of forms or otherwise; and

"(3) provide, whenever possible, for the consolidation of periodic reports required under programs referred to in paragraph (1) into one summary report submitted at such intervals as may be designated by the Secretary.".

TITLE IV—ESTABLISHMENT OF FOREIGN-TRADE ZONES IN ENTERPRISE ZONES

SEC. 401. (a) In processing applications for the establishment of foreign-trade zones pursuant to an Act entitled "To provide for the establishment, operation, and maintenance of foreign-trade zones in ports of entry of the United States, to expedite and encourage foreign commerce, and for other purposes", approved June 18, 1934, the Foreign-Trade Zone Board shall consider on a priority basis and expedite, to the maximum extent possible, the processing of any application involving the establishment of a foreign-trade zone within an enterprise zone designated pursuant to section 7871 of the Internal Revenue Code of 1954.

(b) In processing applications for the establishment of ports of entry pursuant to an Act entitled "An Act making appropriations for sundry civil expenses of the Government for the fiscal year ending June thirtieth, nineteen hundred and fifteen, and for other purposes", approved August 1, 1914, the Secretary of the Treasury shall consider on a priority basis and expedite, to the maximum extent possible, the processing of any application involving the establishment of a port of entry which is necessary to permit the establishment of a foreign-trade zone within an enterprise zone.

(c) In evaluating applications for the establishment of foreign-trade zones and ports of entry in connection with enterprise zones, the Foreign-Trade Zone Board and the Secretary of the Treasury shall approve the applications to the maximum extent practicable, consistent with their respective statutory responsibilities.

DESCRIPTION OF S. 2298

ENTERPRISE ZONE TAX ACT OF 1982

SCHEDULED FOR HEARINGS

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

PREPARED BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

The Subcommittee on Savings, Pensions, and Investment Policy of the Senate Finance Committee has scheduled public hearings on April 15 and 16, 1982, on S. 2298, the Enterprise Zone Tax Act of 1982 (introduced by Senators Chafee, Heinz, Grassley, Matsunaga and others). This bill is the Administration's proposal to provide tax and other incentives in designated zones in economically distressed areas.

This pamphlet, prepared in connection with the hearings on S. 2298, contains descriptions of the various provisions of the bill. Accompanying each description is a summary of the related provisions of present law. The bill contains four titles: Title I—designation of enterprise zones; title II—tax incentive provisions; title III—regulatory flexibility; and title IV—establishment of foreign trade zones in enterprise zones.

The first part of the pamphlet is a summary of the bill. This is followed in the second part with the description of the provisions of the bill. The third part presents the Administration's estimates of the revenue effects of the bill. An Appendix provides a summary description of area eligibility criteria for Urban Development Action Grants (UDAG).

The Subcommittee previously held hearings on a related bill, S. 1310 (Urban Jobs and Enterprise Zone Act) on July 13 and 16, 1981. A description of S. 1310 is contained in a prior Joint Committee staff pamphlet (JCS-33-81; July 10, 1981).

I. SUMMARY

Present Law

Targeted area

The Internal Revenue Code generally does not contain rules for targeting areas for special tax treatment. However, Code section 103A, relating to mortgage subsidy bonds, defines targeted areas for the purpose of promoting housing development within these areas. Within such areas, defined on the basis of the income of area residents or the general economic condition of the area, rules for the issuance of mortgage subsidy bonds are less restrictive than the generally applicable rules.

Tax credits for employers

Present law contains no provisions under which an employer's tax liability varies according to the location of its employees. Prior law contained the new jobs credit, which provided a tax credit, for 1977 and 1978, based on the increase in the employer's payroll over that of the prior year. Under present law, the targeted jobs tax credit provides a tax credit for a portion of wage payments made to certain groups of employees. These groups generally are defined according to the individual's physical condition, participation in a specified education or rehabilitation program, and economic status.

Tax credit for employees

Under present law the tax liability of an employee working in the United States generally does not vary according to the location of his employment. The earned income credit provides a refundable tax credit for a portion of earned income (wages, salaries, and earnings from self-employment) to families with children and with income less than $10,000.

Investment tax credit

Under present law, a 10-percent regular investment tax credit applies to eligible tangible personal property used in a trade or business or for the production of income. In addition, the credit applies to expenditures to rehabilitate industrial and commercial buildings which are at least 30 years old.

Capital gains taxation

Noncorporate taxpayers deduct from gross income 60 percent of the amount of any net capital gain (the excess of net long-term capital gain over net short-term capital loss) for the taxable year. Corporate taxpayers compute their tax liability using a 28 percent alternative rate applied to net capital gain, if the tax computed using that rate is lower than the corporation's regular tax. (The highest regular corporate tax rate is 46 percent for taxable income over $100,000.)

Net operating loss carryovers

Under present law, net operating losses attributable to a taxable year generally may be carried back 3 years and forward 15 years and thus may be deducted from income attributable to other taxable years within this period.

Industrial development bonds

Although interest on State and local bonds used to finance trade or business activity is generally taxable, various exceptions are provided, including bonds issued in certain "small issues."

Regulatory flexibility

Present law provides that certain regulatory procedures are to be followed in order to lighten the regulatory burden on small businesses, small nonprofit organizations, or small governmental jurisdictions.

Foreign trade zones

A foreign trade zone may be established within any port of entry, and for imported goods shipped into a zone, duties are not levied until and unless goods are sent into other United States territory.

Summary of the Bill

Businesses and employers located in an enterprise zone would be entitled to various tax incentives and special regulatory status, as summarized below.

Title I. Designation of enterprise zones

Enterprise zones would be designated by the Secretary of Housing and Urban Development after competitive review of State and local government nominations. Each nominated zone would have to satisfy various requirements concerning economic, demographic, and physical characteristics. The State and local governments seeking designation of a nominated area as an enterprise zone would be required to commit themselves to specific actions to enhance the development of the area. The Secretary would be required to designate up to 25 areas as enterprise zones in each of three successive years after enactment of the bill. A designation would remain in effect for 24 years, unless a shorter period were requested by the nominating governments, or the Secretary revoked the designation.

Title II. Tax incentive provisions

Tax credits for zone employers

Employers would be allowed two nonrefundable tax credits. First, a credit would be allowed equal to 10 percent of qualified wages in excess of the amount of qualified wages paid in the 12-month period before the area was designated as an enterprise zone. Qualified wages would be wages paid (subject to a limitation) to qualified employees, i.e., individuals 90 percent or more of whose services directly related to the zone business and 50 percent of whose services were performed in the zone. Second, a credit would be available for a portion of wages paid to certain disadvantaged individuals who were qualified employees.

Tax credit for zone employees

Qualified employees, as defined above, would be allowed a nonrefundable tax credit of 5 percent of earnings subject to a maximum.

Investment tax credit for zone property

An additional investment tax credit of from 3 to 10 percent, depending on the type of property, would be allowed for real and personal property used in a trade or business in an enterprise zone.

Elimination of capital gains taxation

Capital gains taxes would be eliminated on all net capital gains on the sale or exchange of property used in an enterprise zone in the active conduct of a trade or business or on an interest in a qualified business. A qualified business would be a person at least 80 percent of whose gross receipts were attributable to the active conduct of a trade or business (including rental of real estate) within an enterprise zone and substantially all the assets of whom are located within a zone. Conforming changes would be made in the minimum tax provisions.

Extension of net operating loss carryover period

A net operating loss attributable to zone business could be carried forward for the remaining life of the zone or 15 years, whichever is longer.

Small issue industrial development bonds

Future legislative restrictions on small issue industrial development bonds generally would not apply to bonds, the proceeds of which are used for property located in a zone.

Tax simplification

The Internal Revenue Service would be required to simplify the administration of tax provisions added by this bill.

Title III. Regulatory flexibility

Upon request, Federal agencies and regulatory bodies could relax any regulatory requirements within zones, except requirements provided by statute or affecting civil rights, safety and public health.

Qualified businesses, any government nominating an area subsequently designated as an enterprise zone, and any not-for-profit enterprise operating within a zone would be accorded the same treatment under the Regulatory Flexibility Act as is now given to certain small entities.

Title IV. Foreign trade zones

Whenever possible, foreign trade zones could be established within enterprise zones.

II. DESCRIPTION OF S. 2298

(THE ENTERPRISE ZONE TAX ACT OF 1982)

A. Designation of Enterprise Zones (Title I of the Bill)

Present Law

The Internal Revenue Code contains a provision which defines targeted areas for the purpose of promoting economic development within those areas. In section 103A, relating to mortgage subsidy bonds, some rules for issuance of mortgage subsidy bonds for targeted areas are not as restrictive as the generally applicable rules. These rules were enacted in the Mortgage Subsidy Bond Tax Act of 1980 (P.L. 96–499).

For purposes of mortgage subsidy bonds, a targeted area is either a qualified census tract or an area of chronic economic distress. A qualified census tract is a tract in which 70 percent or more of the families have income which is 80 percent or less of the statewide median income. Areas of chronic economic distress are to be designated by a State according to its standards, and the designation must be approved by the Secretaries of Treasury and Housing and Urban Development. In evaluating a State designation, the Secretaries must use as criteria (1) the condition of the housing stock, (2) the need for housing assistance as indicated by low per capita income, a high percentage of families in poverty, a high number of welfare recipients, and high unemployment rates, (3) the potential for designation to improve housing conditions in the area, and (4) the existence of a housing assistance plan which provides a displacement program and a public improvements and services program.

Several other provisions of the Code provide special tax treatment for specific areas. Section 4994(e) exempts crude oil produced in certain areas of Alaska from the windfall profit tax. In addition, certain domestic corporations deriving income from Puerto Rico and possessions of the United States (e.g., Guam) are eligible for a tax credit that eliminates the U.S. tax on that income. To qualify for the credit, the corporation must derive 80 percent or more of its gross income for the three immediately preceding years from sources within Puerto Rico or a possession of the United States and it must derive at least 50 percent of its gross income for that period from the active conduct of a trade or business within those countries. If a corporation meets these requirements, it is allowed a credit equal to the U.S. tax attributable to the corporation's trade or business related income derived from Puero Rico or the possession.

Explanation of Provisions

The bill would amend the Internal Revenue Code to provide criteria for the designation of enterprise zones.

1. Definition of enterprise zones

An enterprise zone would be any area in the United States or its possessions which is nominated as an enterprise zone by one or more local governments and the government of the State in which it is located, if the Secretary (of Housing and Urban Development) approves the designation. The Secretary could approve the designation only after consultation with the Secretaries of Agriculture, Commerce, Labor, and the Treasury, the Director of the Office of Management and Budget, and the Administrator of the Small Business Administration. In the case of an enterprise zone on an Indian reservation, the Secretary of the Interior would have to be consulted.

The term "State" would include the District of Columbia, Puerto tary of the Interior would have to be consulted.

The term "State" would include the District of Columbia, Puerto Rico, the Virgin Islands, Guam, American Samoa, the Northern Mariana Islands, and the possessions of the United States. The term local government would include the city, town, township, parish, village or other form of municipal government when the nominated area is within an incorporated area, and the county government when the nominated zone is within an unincorporated area.

Before designating any area as an enterprise zone, the Secretary of HUD would have to promulgate regulations, drawn up after consultation with the above federal officials, describing (1) the nominating procedures, (2) the size and population characteristics of an enterprise zone, (3) other standards for designation as an enterprise zone to be met by a nominated area, and (4) the procedures for comparing nominated areas using the criteria specified, in items 4 and 5 below, for evaluating commitments made by State and local governments and for establishing priorities to be applied in making designations.

The Secretary could make designations as enterprise zones only during a 36-month period that begins on the earlier of the effective date of the regulations, or January 1, 1983. During each of the three 12-month periods, not more than 25 nominated areas could be designated as enterprise zones.

The Secretary could not designate an area as an enterprise zone until he had received assurances that the State and local governments had the authority to make commitments with respect to the zone and that the commitments would be fulfilled. Nominations of an area would have to be submitted in the form and with the information required in the Secretary's regulations. The Secretary also would have to determine that the information submitted with the nomination is reasonably accurate and that no portion of the nominated are already was included in an enterprise zone or an area nominated as an enterprise zone.

A nomination of an area first would have to be made by a local government and followed by a confirming nomination by the State government, or vice versa. In the case of a nomination of an area on an Indian reservation to be an enterprise zone, the reservation governing body, as determined by the Secretary of the Interior, would be deemed to be both the State and local government for the reservation.

2. Period of effect of designation

Under the bill, any enterprise zone designation would remain in effect from the date of designation to December 31 of the year 24 years later, or to an earlier date stipulated by the State and local governments in their nomination application, or until the revocation of the zone designation by the Secretary. The Secretary could revoke a zone designation if he determined that the State or local government was not complying substantially with the required State or local government commitments.

3. Area requirements

The Secretary could designate an area nominated as an enterprise zone, if it meets requirements concerning size, population, area boundaries, unemployment, poverty and other signs of economic distress. A description of these requirements follow:

a. The area would be required to be within the jurisdiction of the government seeking the designation and to have a continuous boundary.

b. The most recent census would have to show that area population is at least 4,000 if the area is included within a standard metropolitan statistical area with 50,000 or more people, or at least 2,500 in areas of smaller population, or the area would have to be entirely within an Indian reservation (as determined by the Secretary of the Interior).

c. The Secretary would have to determine that the area is one of pervasive poverty, unemployment, and general distress, and is located wholly within an area which meets the requirements for Federal assistance under section 119 of the Housing and Community Development Act of 1974 as in effect on the date of enactment.[1] (See Appendix for a description of the area eligibility requirements under section 119.)

d. At least one of four additional requirements would have to be satisfied: (1) The average annual rate of unemployment, as determined by the most recently available data from the Bureau of Labor Statistics, would have to be at least 1½ times the average national unemployment rate for the same time period; (2) according to its most the area has a 20 percent or higher poverty rate in each census tract, minor civil division or census county division; (3) at least 70 percent of the households living in the area would have to have income below 80 percent of the median income of the households of the government designating the area (determined in the same manner as under section 119(b)(2) of the Housing and Community Development Act of 1974); or (4) the population in the area would have to have decreased by 20 percent or more between 1970 and 1980, as derived from census data.

4. Required State and local government commitments

Under the bill, no area would be designated as an enterprise zone unless the local government and the State in which it is located agreed in writing that during any period during which the area was an enterprise zone, these governments would follow a course of action designed to reduce the various burdens borne by employers or employees in the area.

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[1] Section 119 establishes a program of urban development action grants (UDAG) to severely distressed cities and urban counties to alleviate physical and economic deterioration through reclamation of neighborhoods.

A course of action under the commitment could be implemented by the State and local governments and private nongovernmental entities, and could be funded from the proceeds of any Federal program. A course of action within the enterprise zone could include (but would not be limited to) (1) a reduction of tax rates or fees, (2) an increase in the level or efficiency of local services or experiments with the supply of these services by nongovernmental entities, (3) elimination, reduction or simplification of government requirements, and (4) program involvement by private entities, organizations, neighborhood associations and community groups, particularly from within the nominated zone, including a commitment from these private entities to provide technical, financial, or other assistance to, and jobs or job training for, employees and residents of the area.

5. Priority of designation

The bill would provide criteria for the Secretary to use in evaluating the qualification of areas nominated to be enterprise zones. The Secretary would be required to give special preference to those nominated areas to which the strongest and highest quality commitments, discussed in item 4 above, have been promised, taking into account the fiscal ability of the nominating governments to provide tax relief. During the evaluation of nominated areas, the Secretary would be required to give a higher evaluation to nominated areas with the following additional characteristics: (1) strongest and highest quality contributions in addition to commitments under 4 above; (2) most effective and enforceable guarantees provided by nominating State and local governments that proposed courses of action would actually be carried out for the duration of the designation; (3) high levels of poverty, unemployment and general distress, particularly those in proximity to concentrations of disadvantaged workers or long-term unemployed individuals and strong likelihood that zone residents who satisfy these criteria would receive jobs in the zone; (4) zone size and location that would stimulate primarily new economic activity and minimize unnecessary Federal tax losses; (5) most substantial commitments by private entities of additional resources and contributions, including creation of new or expanded business activities; and (6) nominated zones which best exhibit such other factors, to be determined by the Secretary, that would be consistent with the program's intent and important in minimizing unnecessary loss of Federal tax revenues.

6. Interaction with other Federal programs

a. General revenue sharing

Present Law

The general revenue sharing program, as authorized by the State and Local Fiscal Assistance Amendments of 1980 (P.L. 96-604), provides payments to local governments, on an entitlement basis, of $4.6 billion in both fiscal year 1982 and fiscal year 1983. Payments to State governments are authorized for these years, but are limited to the amount of categorical grant assistance that a State returns to the Federal Government. No funds have been appropriated under these State government authorizations and no regulations have been issued establishing procedures for returning grant funds to the Federal Government. Subject to few restrictions, State and local governments may use the funds for any purpose they deem appropriate.

The allocation of funds among State and local governments under the general revenue sharing program is determined under formulas which take into account several characteristics of the areas. These include population, urbanized population, per capita income, education spending, intergovernmental transfers, inome tax collections, and total tax collections.

Explanation of Provision

Any reduction of taxes under any required program of local commitment under the enterprise zone program would be disregarded in determining the eligibility of a State or local government for, or the amount or extent of, any assistance or benefits under any law of the United States.

b. Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970

Present Law

The Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (P.L. 91-646) governs the responsibilities of Federal agencies which displace residents, businesses and farms because of an acquisition of real property or a requirement that property be vacated which is attributable to Federal or federally assisted projects or programs. Various forms of relocation assistance are provided under the Act. This assistance includes moving expenses, reimbursement of business losses, advisory services, and partial payments for or, under certain circumstances, actual provision of, replacement housing.

Explanation of Provision

Designation of an enterprise zone would not constitute approval of a Federal or federally assisted program or project as those terms are used in the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. No person displaced from real property located in an area designated as an enterprise zone would have any rights or be entitled to any benefit pursuant to that Act as a result of such designation.

B. Tax Incentive Provisions (Title II of the Bill)

1. Tax credits for employers

a. Credit for increased zone employment

Prior Law

Under present law, there are no provisions under which an employer's Federal income tax liability varies according to the location of its employees or his change in employment. However, a provision in effect in recent years did provide a credit which varied with an employer's increased employment.

The Tax Reduction and Simplification Act of 1977 provided a new jobs tax credit for 1977 and 1978. The credit was 50 percent of the increase in each employer's wage base under the Federal Unemployment Tax Act (FUTA) above 102 percent of that wage base in the previous year. The FUTA base for 1977 consisted of wages paid of up to $4,200 per employee.[1] The employer's deduction for wages was reduced by the amount of credit.

The total amount of the credit had four limitations: (1) the credit could not be more than 50 percent of the increase in total wages paid by the employer for the year above 105 percent of total wages paid by the employer in the previous year, (2) the credit could be no more than 25 percent of the current year's FUTA wages, (3) the credit for a year could not exceed $100,000, and (4) the credit could not exceed the taxpayer's tax liability. Credits which exceeded tax liability for a year could be carried back for 3 years and carried forward for 7 years.

Although most employers were able to use the returns they filed for purposes of complying with FUTA as a basis for claiming the credit, special rules were provided for businesses, such as farms and railroads, not covered under FUTA. Special rules also were provided for computation of the credit by groups of companies under common control, for businesses with employees working abroad, and for businesses affected by acquisitions, dispositions, and other changes in business form. Additional rules were provided for allocating the credit among members of a partnership and of a subchapter S corporation.

Explanation of Provision

Under the bill, employers would be permitted to claim a nonrefund-
curred during the taxable year. In general, "qualified wages" would be
able tax credit equal to 10 percent of "qualified wages" paid or in-
ployees in excess of the qualified wages paid by that employer during
the 12 calendar month period prior to enterprise zone designation

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[1] For 1978, the FUTA base went up to $6,000. In order to make the 1978 wage base comparable with 1977 for purposes of the jobs credit, only the first $4,200 of the FUTA wage base for each employee was included in the computation.

(base period wages). If an employer was not engaged in an active trade or business in the area during that 12-month period, then base period wages would be zero.

Under the bill, a qualified employee would be any employee 90 percent or more of whose services directly relate to the conduct of the employer's trade or business located in an enterprise zone and who performs at least 50 percent of his service for the employer in an enterprise zone. A qualified employee would not include an employee with respect to whom the employer claimed a WIN [2] or targeted jobs credit.

Qualified wages for any employee could not exceed 2½ times the FUTA wage base (currently $6,000) in effect in any taxable year. Further, qualified wages would have to be reduced by any amount of federally funded on-the-job training payments the employer receives or is entitled to receive for such individual for that period and by any amount claimed as a credit under the qualified disadvantaged individual credit discussed below.

The increased enterprise zone employment credit would be phased out starting in the taxable year of the taxpayer in which falls the twenty-first anniversary of the enterprise zone designation, when the credit would be reduced to 7½ percent of qualified wages. The credit would then be reduced by 2½ percentage points for each succeeding year until fully terminated.

Rules analogous to those contained in the present targeted jobs credit would control allocation of the credit among commonly controlled corporations and other business entities. Special rules would also apply to allocate the credit between subchapter S corporations and their shareholders, and estates and trusts and their beneficiaries. Finally, special rules would apply to allocate "base period wage" amounts between persons acquiring and disposing of major portions of a trade or business or of a separate unit of a trade or business.

The allowable amount of the credit would be limited to the taxpayer's tax liability, but unused credits could be carried forward for the remaining life of the enterprise zone or 15 years, whichever is longer.

Effective Date

The provision would apply to qualified increased employment expenditures made after the date of an area's designation as an enterprise zone.

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[2] The WIN credit does not apply to amounts paid or incurred in taxable years beginning after 1981. AFDC recipients and WIN registrants, formerly eligible for the WIN credit, are now a targeted group for purposes of the targeted jobs credit.

b. Credit for zone employment of disadvantaged individuals

Present Law

Under present law, there are no provisions under which an employer's Federal income tax liability varies according to the location of the employees. However, the targeted jobs tax credit does allow a credit against tax for a portion of wage payments made to certain types of employees.

The targeted jobs tax credit, which applies to wages paid to eligible individuals who begin work for the employer before January 1, 1983, is available on an elective basis for hiring individuals from one or more of nine target groups. The target groups are (1) vocational rehabilitation referrals; (2) economically disadvantaged youths aged 18 to 25; (3) economically disadvantaged Vietnam-era veterans; (4) Supplemental Security Income (SSI) recipients; (5) general assistance recipients; (6) economically disadvantaged cooperative education students; (7) economically disadvantaged former convicts; (8) AFDC recipients and WIN registrants; and (9) involuntarily terminated CETA employees.

The credit is equal to 50 percent of the first $6,000 of qualified first-year wages and 25 percent of qualified second-year wages paid to a member of a targeted group. Thus, the maximum credit is $3,000 per individual in the first year of employment and $1,500 per individual in the second year of employment. The employer's deduction for wages, however, must be reduced by the amount of the credit.

The credit is subject to several limitations. For example, wages may be taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee are for services in the employer's trade or business. In addition, wages for purposes of the credit do not include amounts paid to an individual for whom the employer is receiving payments for on-the-job training under a Federally-funded program.

For purposes of determining the years of employment of an employee and whether the $6,000 cap has been reached with respect to any employee, all employees of any corporation that are members of a controlled group of corporations are treated as if they are employees of a single corporation. Under the controlled group rules, the amount of credit allowed to the group is generally the same which would be allowed if the group were a single company. Comparable rules are provided for partnerships, proprietorships, and other trades or business (whether or not incorporated) under common control.

The credit may not exceed 90 percent of the employer's tax liability after being reduced by other nonrefundable credits. Excess credits may be carried back three years and carried forward fifteen years.

Explanation of Provision

General

Under the bill, employers also would be entitled to a credit with respect to qualified wages paid to certain "qualified disadvantaged individuals" (*i.e.*, employees in certain specified categories). In general, for purposes of this credit, "qualified wages" would be all wages paid or incurred by an employer during the taxable year for employment of qualified disadvantaged individuals, reduced by the amount of any federally funded payments the employer receives or is entitled to receive for on-the-job training for such individuals for the taxable year. There would be no dollar limitation on wages eligible for the credit.

This credit would be allowable for a total of seven years with respect to any qualified employee. The credit would be 50 percent of qualified wages received by a qualified disadvantaged individual during the 36-month period beginning the day the individual began work in an enterprise zone for an employer. The credit would then be reduced 10 percentage points during each of the succeeding twelve-month periods: to 40 percent of qualified wages attributable to services rendered in the fourth year, 30 percent of qualified wages attributable to services rendered in the fifth year, 20 percent of qualified wages attributable to services rendered in the sixth year, and 10 percent of qualified wages attributable to services rendered in the seventh year. These time periods would not take into account any period of time during which the individual is unemployed. The credit with respect to any one employee would be terminated after the seventh year of employment.

Categories eligible for the credit

A qualified disadvantaged individual would be any individual who is hired after the designation of an area as an enterprise zone, and who would be an eligible employee under the increased enterprise zone employment credit (i.e., who performs 90 percent or more of his services for the enterprise zone business and 50 percent or more of his services in the enterprise zone). Furthermore, a qualified disadvantaged employee would have to fall into at least one of seven categories of disadvantaged individuals: (1) vocational rehabilitation referrals, (2) economically disadvantaged individuals, (3) eligible foster children, (4) SSI recipients, (5) general assistance recipients, (6) eligible handicapped individuals, and (7) eligible AFDC recipients.

Four of the seven categories, (1) vocational rehabilitation referrals, (2) SSI recipients, (3) general assistance recipients, and (4) eligible AFDC recipients, are similar to targeted groups presently contained in the targeted jobs credit. The other categories are defined in the bill as follows:

Economically disadvantaged individuals.—An economically disadvantaged individual would be defined as an individual who is certified by the designated local agency as being a member of a family that had an income during the 6 months prior to the determination month which, if annualized, was equal to or less than the AFDC and food stamp benefits available to a family with no income.

Foster children.—Foster children would be individuals certified by the designated local agency as receiving State or local government benefits under a program to assist foster children.

Handicapped individuals.--Handicapped individuals would be individuals who, pursuant to regulations issued by the Secretary, are certified by the designated local agency as either disabled and living at home, or institutionalized or receiving the services in (or of) a sheltered workshop, prison, hospital, or other similar institution.

Other rules

Rules analogous to those contained in the present targeted jobs credit would control certification procedures and allocation of the credit among controlled businesses, between subchapter S corporations and their shareholders, and between estate and trusts and their beneficiaries.

Any credit taken with respect to an employee would be recaptured if the employee were terminated at any time during the first 270 days of employment, or before the close of 270 calendar days after the 90th day of employment, with certain exceptions, including voluntary termination. However, if the major portion of a trade or business, or the major portion of a separate unit of a trade or business of an employer were acquired by another employer, then employment of any qualified employee would not be terminated for purposes of this credit if the employee continued to be employed in that trade or business.

This credit would be phased out by 25 percent per year starting in the taxable year of the taxpayer in which the twenty-first anniversary of zone designation falls. No deduction would be allowable to an enterprise zone employer for that portion of wages paid or incurred for the taxable year equal to the amount of credits allowable under either the increased enterprise zone employment credit or the economically disadvantaged individual credit allowable for the taxable year.

The allowable amount of the credit would be limited to the taxpayer's tax liability, but unused credits could be carried forward for the remaining life of the enterprise zone or 15 years, whichever is longer.

Effective Date

These provisions would apply to wages paid after the date of an area's designation as an enterprise zone.

2. Tax credit for zone employees

Present Law

Under present law, the tax liability of an employee working in the United States generally does not vary according to the location of his employment. However, a refundable credit, the earned income credit, is allowed to certain low-income families with children.

Under the earned income credit, taxpayers living with children in the United States are eligible for a refundable tax credit equal to 10 percent of the first $5,000 of earnings. The maximum credit is $500. The maximum credit is reduced by 12.5 percent of the taxpayer's adjusted gross income (or if greater, earned income) in excess of $6,000. Thus, no credit is available to taxpayers with incomes of $10,000 or more.

Explanation of Provision

Under the bill, qualified employees would be entitled to claim a nonrefundable tax credit equal to 5 percent of qualified wages for the taxable year. For purposes of this credit, qualified wages would be equal to all remuneration paid for services of a qualified employee, but not including any compensation received from the Federal Government or any State or subdivision of a State, up to 1½ times the wage base in effect for the purpose of the Federal Unemployment Tax Act (FUTA) (currently $6,000). Thus, the maximum credit for any taxable year until the FUTA base is changed would be 5 percent of $9,000 or $450.

For purposes of this credit, a qualified employee would be an individual at least 90 percent of whose services are directly related to an enterprise zone trade or business and at least 50 percent of whose services are performed in an enterprise zone, and who is not an employee of the Federal Government or any State or local subdivision of any State. The determination of whether an individual was a qualified employee would be made separately with respect to each of the individual's employers.

The credit would phase out starting in the taxable year of the employee in which fell the twenty-first anniversary of enterprise zone designation and would be phased out completely in four years.

Employers would be required to report to qualified employees the amount of wages paid to such employees.

Effective Date

These provisions would be effective with respect to taxable years ending after the date of an area's designation as an enterprise zone.

3. Investment tax credit for zone property

Present Law

Under existing law, a regular investment tax credit is allowed for investment in tangible personal property and other tangible property (generally not including buildings or structural components) used in connection with manufacturing, production, or certain other activities. For eligible property in the 3-year recovery class, a 6-percent regular credit is allowed. For other eligible property, a 10-percent regular credit is allowed.

Buildings and their structural components (other than elevators and escalators) generally do not qualify for the regular investment credit. However, in the case of qualified rehabilitation expenditures, a 15-percent credit is allowed for nonresidential buildings at least 30 years old, a 20-percent credit is allowed for nonresidential buildings at least 40 years old, and a 25-percent credit is allowed for certified historic buildings. The basis of the asset, for such purposes as capital cost recovery deductions, is reduced by the amount of the 15-percent or 20-percent credit. The rehabilitation credit is allowed in lieu of any regular or energy credit that is otherwise allowable. Unused investment credits may be carried forward for 15 years.

Explanation of Provision

Under the bill, an additional investment tax credit would be allowed for capital investments in an enterprise zone.

Zone personnel property

In the case of property eligible for the regular investment tax credit (other than elevators and escalators), an additional 3-percent credit would be available for 3-year recovery property and an additional 5-percent credit would be available for 5-year property, 10-year property, and 15-year public utility property. In order to be eligible for this additional credit, such property would have to be acquired and first placed in service by the taxpayer in an enterprise zone after designation of the zone. In addition, the taxpayer would have to use the property predominantly in the active conduct of a trade or business within an enterprise zone. Property used or located outside the enterprise zone on a regular basis would not be eligible for the additional credit.

New zone construction property

An additional 10-percent tax credit would be available for 15-year real property (including lodging, elevators and escalators) located in an enterprise zone if the property is acquired or constructed by the taxpayer and used predominantly in the active conduct of a trade or business within the enterprise zone. In the case of property acquired by the taxpayer, the additional credit would be available only if the property was acquired after designation of the zone and only if the original use of the property commenced with the taxpayer. In the case of property constructed, reconstructed, rehabilitated, renovated, expanded, or erected by the taxpayer, the credit would be available only to the extent of any construction or erection after designation of the enterprise zone.

For property eligible for this additional 10-percent tax credit (15-year real property), the basis of the property would be reduced by the amount of the additional credit allowable.

Recapture

If property for which an enterprise zone credit was claimed by a taxpayer ceases to be enterprise zone property of the taxpayer (other than by expiration or revocation of the designation of the zone), a portion of the enterprise zone credit would be recaptured. Property would cease to be enterprise zone property of a taxpayer if, for example, the taxpayer disposed of the property, removed the property from the enterprise zone, or ceased to use the property in the active conduct of a trade or business within the enterprise zone.

The amount of the enterprise zone credit subject to recapture would be the difference between the amount of credit allowed for the property and a recomputed credit based on the amount of time the property was enterprise zone property of the taxpayer. The recomputed credit would bear the same ratio to the amount of credit originally allowed as the number of taxable years in which the property was enterprise zone property of the taxpayer bears to the number of years over which the property is depreciated for purposes of computing earnings and profits. The recapture periods would be as follows:

	Years
3-year property	5
5-year property	12
10-year property	25
15-year public utility property	35
15-year real property	35

Thus, for example, no enterprise zone credit would be recaptured with respect to 3-year recovery if it remained enterprise zone property of the taxpayer for 5 taxable years. If this property had been enterprise zone property of the taxpayer for only 4 taxable years, 20 percent of the enterprise zone credit would be recaptured.

Carryover period

Unused investment tax credit amounts attributable to the additional enterprise zone percentage could be carried forward for the remaining life of the enterprise zone or 15 years, whichever is longer.

Effective Date

The provision would apply to qualified expenditures made or incurred after the date an area's designation as an enterprise zone.

4. Elimination of capital gains taxation

Present Law

Overview

Under present law, gain or loss from the sale or exchange of a capital asset receives special tax treatment. For this purpose, the term "capital asset" generally means property held by the taxpayer. However, capital assets generally do not include (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications.

In addition, gains from sales or exchanges of certain depreciable or real property used in the taxpayer's trade or business may be treated as capital gains under certain circumstances.

Present law generally does not categorize gains or losses with regard to the location of an asset, or the specific purpose for which it is used. In specific instances, however, present law allows nonrecognition, or rollover, of gain or loss from certain property, such as owner-occupied housing, to the extent that the proceeds are reinvested in an approved manner. In addition, present law treats some capital gain as ordinary income to the extent of certain previously taken deductions, e.g., depreciation recapture.

Noncorporate capital gains deduction

Noncorporate taxpayers may deduct from gross income 60 percent of the amount of any net capital gain (the excess of net long-term capital gain over net short-term capital loss) for the taxable year. The remaining 40 percent of the net capital gain is included in gross income and taxed at the otherwise applicable regular income tax rates. As a result, the highest tax rate applicable to a noncorporate taxpayer's entire net capital gain is 20 percent, i.e., 50 percent (the highest individual tax rate) times the 40 percent of the entire net capital gain includible in adjusted gross income.

Corporate capital gains tax

An alternative tax rate of 28 percent applies to a corporation's net capital gain (the excess of net long-term capital gain over net short-term capital loss) if the tax computed using that rate is lower than the corporation's regular tax. (The highest regular corporate tax rate is 46 percent for taxable income over $100,000.)

Minimum taxes

"Add-on" minimum tax

Present law imposes an "add-on" minimum tax on certain specified tax preference items. Accelerated depreciation on real property is a tax preference item for all taxpayers. Accelerated depreciation on leased personal property is also a tax preference item for taxpayers, and 18/46ths of a corporation's net capital gain is a tax preference subject to the minimum tax.

Alternative minimum tax

Under present law, an alternative minimum tax is payable by noncorporate taxpayers to the extent that it exceeds their regular income tax, including the "add-on" minimum tax. The alternative minimum tax is based on the sum of the taxpayer's gross income, reduced by allowed deductions, and increased by two tax preference items: (1) "excess" itemized deductions and (2) the capital gains deduction. The alternative minimum tax rate is 10 percent for amounts from $20,000 to $60,000 and 20 percent for amounts in excess of $60,000.

Explanation of Provision

Qualified property and qualified business

The bill would provide special tax treatment for gains and losses from sales or exchanges of "qualified property" held for more than one year. For this purpose, the term "qualified property" would mean (1) tangible personal property used predominantly by the taxpayer in an enterprise zone in the active conduct of a trade or business, (2) real property located in an enterprise zone and which is used predominantly by the taxpayer in the active conduct of a trade or business in a zone and (3) an interest in a corporation, partnership, or other entity if, for the three most recent taxable years of the entity ending before the date of disposition of the interest, or for the part of this period, as the entity was in existence (the qualifying period), the entity was a "qualified business."

Under the provision, the term "qualified business" would mean any person (1) which is actively engaged in the conduct of a trade or business (including rental of real estate) during the qualifying period, (2) with respect to which at least 80 percent of such person's gross receipts for the taxable year would be attributable to the active conduct of a trade or business within an enterprise zone, and (3) substantially all of the tangible assets of which are located within an enterprise zone.

Under the bill, gain from the sale or exchange of an interest in a qualified business would not be treated as gain from the sale or exchange of qualified property to the extent the gain is attributable to (1) any property contributed to the qualified business within the previous 12 months, (2) any interest in a business which is not a qualified business, or (3) any other intangible property not created as part of an active trade or business within an enterprise zone.

Under the bill, the special tax treatment for gains and losses from sales or exchanges of "qualified property" would not cease to be available subsequent to the termination or revocation of an area's designation as an enterprise zone. However, the special tax treatment would not apply after the first sale or exchange of any item of "qualified property" after the designation of an area as an enterprise zone ceases to apply.

Noncorporate capital gains deduction

The bill would provide a special rule for a noncorporate taxpayer's gains and losses from sales or exchanges of qualified property. Under this rule, a noncorporate taxpayer could deduct from gross income an amount equal to the sum of (1) 100 percent of the lesser of the taxpayer's net capital gain, or the net capital gain taking into account only sales or exchanges of qualified property, plus (2) 60 percent of the excess (if any) of the net capital gain over the amount of the net capital gain subject to the 100 percent deduction. This rule, in effect, would allow a noncorporate taxpayer to deduct from gross income 100 percent of any net capital gain from qualified property.

Corporate capital gains tax

The bill would allow a corporation to exclude from taxation net capital gains from qualified property.

Minimum taxes

The bill would eliminate the classification of net capital gains from qualified property as a tax preference item for purposes of the minimum taxes.

Effective Date

These provisions would apply to sales or exchanges after an area's designation as an enterprise zone.

5. Extension of net operating loss carryover period

Present Law

Under existing law, net operating losses attributable to a taxable year generally may be carried back 3 years and forward 15 years and thus may be deducted from income attributable to the other taxable years within this period.

Explanation of Provision

For any taxable year during which a taxpayer conducts an active trade or business within an enterprise zone, the bill provides that a net operating loss attributable to such a business could be carried forward for the remaining life of the enterprise zone or 15 years, whichever is longer.

Effective Date

The provision would apply to net operating losses in taxable years ending after the date of an area's designation as an enterprise zone.

6. Small issue industrial development bonds

Present Law

Interest on State and local government obligations generally is exempt from Federal income tax. However, subject to certain exceptions, interest on State and local issues of industrial development bonds is taxable. An obligation constitutes an industrial development bond if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a governmental unit or tax-exempt organization described in sec. 501(c)(3)[1] and (2) payment of principal or interest on which is secured by an interest in or derived from payments with respect to, property or borrowed money used, or to be used in a trade or business.

Present law provides an exception for certain "small issues" to the general rule of taxability of interest paid on industrial development bonds. This exception applies to issues of $1 million or less if the proceeds are used for the acquisition, construction, or improvement of land or depreciable property.

At the election of the issuer, the $1 million limitation may be increased to $10 million. If this election is made, the exception is restricted to projects where the aggregate amount of outstanding exempt small issues and capital expenditures (financed otherwise than out of the proceeds of exempt small issues) made over or a six-year period[2] does not exceed $10 million. Both the $1 million and $10 million limitations are determined by aggregating the face amount of all outstanding related issues, plus, in the case of the $10 million limitation, certain capital expenditures for all facilities used by the same or related principal users which are located within the same county or same incorporated municipality.

Explanation of Provision

The bill generally provides that the tax provisions applicable to small issue industrial development bonds, as in effect on January 1, 1982, would apply to obligations the major portion of the proceeds of which are to be used directly for any land or depreciable property that is located in an enterprise zone. The only amendments that would be given effect with respect to those obligations would be amendments relating to arbitrage or to registration of such obligations.[3]

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[1] For example, interest on an obligation the proceeds of which are to be used in the trade or business which is not an unrelated trade or business, of a charitable organization, is exempt from tax.

[2] The relevant six-year period is the period beginning three years before the date of issue and ending three years after that date. For issues used for projects which receive UDAG grants, up to $10 million of capital expenditures is exempt from the $10 million limitation.

Effective Date

This provision would apply only with respect to obligations that are issued after the date an area is designated as an enterprise zone and before the designation terminates, provided that the proceeds are used prior to the date the area ceases to be an enterprise zone.

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[3] As part of its fiscal year 1983 budget proposals, the Administration has proposed new restrictions on the issuance of private purpose tax-exempt bonds, reduction of the benefit from tax-exempt bonds by requiring an election between tax-exempt financing and the accelerated cost recovery system, and limitation of the use of small-issue bonds to small businesses. Other parts of the proposal would provide restrictions relating to arbitrage and would require private purpose tax-exempt bonds to be in registered form.

7. Tax simplification

Present Law

In the past, the tax law has imposed various simplification requirements. For example, the Tax Reform Act of 1976 required the Joint Committee on Taxation to conduct a study of simplification of the tax law.[1] In addition, the Revenue Act of 1978 required the Treasury Department to conduct a study of simplification of income tax forms and instructions.[2]

Under present law, one of the duties of the Joint Committee on Taxation is to investigate measures and methods for the simplification of the tax laws (Code sec. 8022(2)).[3]

Explanation of Provision

The bill would provide that it is the sense of the Congress that the Internal Revenue Service should, in every way possible, simplify the administration and enforcement of the tax provisions added to the Internal Revenue Code by this bill.

Effective Date

The provision would be effective upon enactment.

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[1] Sec. 507 of P.L. 94–455. The report, *Issues in Simplification of the Income Tax Laws*, was submitted in September 1977.

[2] Sec. 551 of P.L. 95–600.

[3] For example, at the request of the Joint Committee, the U.S. General Accounting Office conducted a study on simplification of income tax forms and issued a report entitled *Further Simplification of Income Tax Forms and Instructions Is Needed and Possible* (GAO Report No. GGD–78–74; July 5, 1978). The General Accounting Office has conducted numerous other tax administration studies in recent years for the Joint Committee and other congressional committees.

C. Regulatory Flexibility (Title III of the Bill)

Present Law

The Regulatory Flexibility Act (5 USC secs. 602–612) requires Federal regulatory agencies to publish analyses of the economic impact on entities under its coverage of any proposed regulations and to discuss alternatives to those regulations. The Act requires Federal regulatory agencies to undertake a periodic review of their regulations to determine whether they should be changed to minimize their economic impact on the entities covered by the Act.

In general, the purpose of the Regulatory Flexibility Act is to require Federal agencies to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation. To achieve this principle, agencies are required to solicit and consider flexible regulatory proposals and to explain the rationale for their actions to assure that such proposals are given serious consideration. The Act requires that special attention is to be given to small entities. For example, in its initial regulatory flexibility analysis, an agency must describe the impact of a proposed rule on small entities.

Small entities, for purposes of the Regulatory Flexibility Act, are small businesses (generally independently owned and operated business enterprises that are not dominant in their fields of operation), small organizations (independently owned and operated not-for-profit enterprises that are not dominant in their fields), and small governmental jurisdictions (governments of cities, towns, townships, villages, school districts, or special districts, with populations of less than fifty thousand).

Explanation of Provision

Under the bill, Federal agencies and regulatory bodies would be given discretionary authority to relax or eliminate any regulatory requirements within enterprise zones except those affecting civil rights, safety and public health, or those required by statute, such as the Davis-Bacon Act or the Fair Labor Standards Act. This authority could be exercised only upon request of State and local governments.[1]

The bill also would expand the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified business, any government designating an area as an enterprise zone to the extent any regulatory rule would affect the zone, and any not-for-profit enterprise operating within an enterprise zone.

The bill also would provide that the Secretary of Housing and Urban Development would be required to promote the coordination of programs under his jurisdiction and carried on in an enterprise zone and to consolidate requirements for related applications and reports required under these programs.

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[1] Examples of regulations which could be relaxed include regulations governing exports, regulations affecting accounting treatment of loans made by national banks, regulations affecting inventory accounting for tax purposes, regulations affecting issuance of securities, and regulations affecting various energy performance, coal conversion, and conservation regulations.

D. Establishment of Foreign Trade Zones in Enterprise Zones (Title IV of the Bill)

Present Law

Under present law, each port of entry is entitled to at least one foreign trade zone. In a foreign trade zone, foreign merchandise may be received by a company, and the merchandise is not considered to have entered U.S. Customs territory. Thus, dutiable goods may be received free of duty. These goods may be stored, sold, repaired, assembled, distributed, manufactured and displayed within the zone, and then exported or sent into Customs territory of the United States. When sent into Customs territory they become subject to the laws affecting imported merchandise, such as the levy of customs duties.

Foreign trade zones are authorized by the Foreign Trade Zone Board, a Federal agency chaired by the Secretary of Commerce. Such zones typically consist of specific factories, warehouses, or industrial parks.

Explanation of Provision

The bill would require that the Foreign Trade Zone Board should expedite the processing and approval to the maximum extent practicable, of any application involving the establishment of a foreign trade zone within an enterprise zone. The Secretary of the Treasury would be required to give similar consideration to an application for establishment of a port of entry necessary to permit the establishment of a foreign trade zone within an enterprise zone.

III. REVENUE EFFECTS OF THE BILL

The Treasury Department estimates that the bill would reduce fiscal year receipts by $0.1 billion in 1983, $0.4 billion in 1984, $0.8 billion in 1985, $1.0 billion in 1986, and $1.3 billion in 1987. However, for several reasons, these figures may either underestimate or overestimate the actual revenue loss by a considerable degree.

Treasury's estimates are based on the assumption that the zones selected by the Secretary of Housing and Urban Development would have, at the time of designation, average employment of 10,000 and a mix of economic activities similar to those of a sample of distressed areas in several large cities. The language of the bill does not require this average employment and economic mix, however, so that the above figures may not estimate the actual revenue loss. If the average zone has, for example, only 5,000 employees, then actual revenue losses would be $0.05 billion, $0.2 billion, $0.4 billion, $0.5 billion, and $0.7 billion in fiscal years 1983 through 1987, respectively, if the assumptions about the economic mix were correct.

On the other hand, several factors could make the actual revenue loss higher than the Treasury estimates. First, because of data limitations, the Treasury estimates do not take account of losses associated with investments in rental housing and other rental real estate, investments by public utilities, and the revenue loss associated with the capital gains provisions in the bill. Second, the actual mix of economic activities in the zone or attracted to the zone could be very payroll intensive and have a high ratio of investment to payroll, substantially increasing the cost of the tax incentives relative to what was assumed. Finally, the average size of zones when they are actually designated by the Secretary could be much larger than 10,000. If, for example, employment in designated zones were to average 50,000, fiscal year revenue losses would be $0.5 billion in 1983, $2.0 billion in 1984, $4.0 billion in 1985, $5.0 billion in 1986, and $6.5 billion in 1987.

APPENDIX

Area Eligibility Criteria for Urban Development Action Grants (UDAG)

The Urban Development Action Grant (UDAG) program provides grants for economic revitalization and neighborhood reclamation projects. The projects must be located in jurisdictions or areas which meet certain minimum standards of physical and economic distress and which demonstrate provision of housing for low and moderate income individuals and equal opportunity in housing and employment. Currently, more than 350 cities of population over 50,000 and more than 10,000 smaller cities are eligible for UDAG grants, either in whole or in part.

Area eligibility factors

The statute authorizing the program specifies six factors to be taken into account in determining an area's eligibility, and the Secretary of Housing and Urban Development provides by regulation the numerical levels of these factors which are required for eligibility. The six factors currently in effect are as follows:

a. Poverty rate.—At least 10.92 percent of the population of the jurisdiction have incomes at or below the poverty level, based on 1970 Census data.

b. Age of housing.—At least 33.38 percent of the jurisdiction's year-round housing units were constructed prior to 1940, based on U.S. Census data.

c. Growth in per capita income.—The net increase in per capita income for the period 1969 to 1977 must have been $2,694 or less, based on U.S. Census data.

d. Population growth.—For the period 1960–1978, the population growth must have been 0.2 percent or less in cities of under 50,000 population, or 17.78 percent or less in larger cities or urban counties.

e. Employment growth in retailing and manufacturing.—The rate of growth in retail and manufacturing employment for the period 1972 to 1977 must have been 6.74 percent or less.

f. Unemployment rate.—The 1979 unemployment rate must have been at least 5.64 percent, based on Bureau of Labor Statistics data.

Population criteria

Eligibility of areas depends on their population:

1. Cities over 50,000.—Cities and urban counties with a population of at least 50,000 must meet at least three of the above six criteria. If the poverty rate is less than half the figure above (item (a)), then the area must meet at least four of the remaining five criteria.

2. Cities of population between 25,000 and 50,000.—Cities with population between 25,000 and 50,000 must meet at least three of the first five criteria. If the poverty rate is less than half the figure above (item (a)), then the area must meet all four of criteria (b) through (e), above. If the poverty rate is at least double the figure above (item (a)), the city must also meet only one of the criteria (b) through (e), above. If the percentage of housing units constructed prior to 1940 is at least double the figure above (item (b)), then the city must also meet only the poverty rate criterion (item (a)).

3. Cities of population under 25,000.—A city under 25,000 must meet three of the first four criteria (items (a) through (d)). If the poverty rate is at least double the figure in item (a) above, then the city must meet only one of the other three criteria. If the percentage of housing units constructed prior to 1940 is at least double the figure above (item (b)), then the city must also meet only the poverty rate criterion (item (a)).

4. Areas within ineligible cities.—Severely distressed areas within otherwise ineligible communities may be designated as "pockets of poverty" and thus made eligible. The area must be composed of contiguous census tracts, enumeration districts or block groups. In cities of population over 50,000, the area must contain the lower of 10,000 persons or 10 percent of the jurisdiction's population. For smaller cities, the area must contain the greater of 2,500 persons or 10 percent of the jurisdiction's population. For all cities, no enumeration district or block group with a median income level greater than 120 percent of the jurisdiction's median income may be included in the pocket of poverty. In addition, at least 70 percent of the families and unrelated individuals in the area must have incomes below 80 percent of the jurisdiction's median income, and at least 30 percent of area residents must have incomes below the poverty level.

Senator CHAFEE. Good morning.

This is the initial hearing on the administration's Enterprise Zone Tax Act of 1982. This legislation represents a major contribution by President Reagan to the redevelopment of economically distressed cities and towns throughout America.

Those of us who have worked on the enterprise-zone concept over the last 2 years welcome the administration's strong support, because such support is crucial to the success of our legislative efforts this year.

As a key part of the President's economic recovery program, I and the other 25 cosponsors of the Enterprise Zone Tax Act will pull out all stops to insure its enactment during this session. In other words, we are committed to see this bill passed.

We are privileged to have the administration's lead spokesmen for the enterprise-zone issue testifying before the subcommittee today. The Secretary of HUD, Secretary Pierce, will be here in a few minutes. In addition, Treasury Assistant Secretary Chapoton will review the bill's tax provisions, and Commerce Assistant Secretary Brady will discuss the possible roll of foreign trade zones within an enterprise zone.

Following the witnesses from the executive branch we will hear testimony from a number of State and local officials who will comment on the progress of enterprise-zone legislation in their own jurisdictions and hopefully on the compatability of zone legislation being developed at both the State and Federal level.

Then we will have some private sector witnesses who will have some advice for this subcommittee on other issues which have persisted throughout our work on enterprise zones for the last 2 years.

Some of the questions are: Are there adequate incentives in the bill to encourage the startup of new small businesses? Is the program too complex for unsophisticated entrepreneurs to take advantage of? What will be the impact on zone residents? How about the effect on employers located just outside the zone?

We look forward to these and other comments that the witnesses may have so that we can get together and on with the enactment of the best possible enterprise zone bill.

We are very honored to have the chairman of the full committee here today, Senator Dole.

Senator, we would be delighted to hear any statement you might have.

Senator DOLE. Thank you, Mr. Chairman. I would like to include a statement in the record and summarize briefly.

We are pleased to have with us this morning Secretary Pierce, who will be here momentarily; and Assistant Secretary Chapoton, who we have had many times before this committee; Assistant Secretary Brady, and others; and certainly our colleague John Heinz and Senator Boschwitz who have had a long-time interest in this legislation.

As I think the record will indicate, we have had hearings in the past. In the midst of the tax bill last year, on July 13 and July 16, we had hearings on the concept, and now we have a specific proposal before us; so I think our job becomes clearer. Some decisions have been made, but in some cases a decision raises new questions. For example, to support job creation in enterprise zones, the administration proposes three employment tax credits, two available to the employer and one to the employee. Frankly, the effectiveness of such credits, as in the case of targeted jobs credits, certainly is not proven. We will have to consider whether an effective wage subsidy can be devised through the Tax Code or whether another approach might be better.

Some general concerns about the enterprise-zone concept also remain, and they will have to be discussed. We cannot be certain that a particular proposal will insure new economic activity as opposed to channeling existing activity to certain areas; but we should do our best to find what provisions are most likely to achieve that result.

Similarly, no package of tax incentives is guaranteed to attract business to an area plagued by poverty, a deteriorating infrastructure, and in many cases high crime rates. But no one, presumably, is looking for guarantees—the goal is to assemble the most meaningful set of tools for fostering private enterprise in areas where government subsidies and regulations have failed.

Still, there are many questions, and they are not going to be easy to resolve. I think we should indicate at the outset that we, at least some of us, have a number of questions about the legislation. Some of these have already been raised by the chairman.

What will happen, for example, to those who exist on the periphery of an area designated as a zone? Will they all move into a zone, leaving a no-man's land? Or will they stay put despite a competitive disadvantage relative to zone business?

For purposes of the tax provisions, how should we treat businesses engaged in transportation or moving? How much of their business is really zone business? Nor is it clear how strong a package of State and local incentives will be adequate to win HUD approval or to generate significant economic activity. Local tax abatement has had mixed results and probably needs some more attention.

We are not certain about the cost of the proposal. We have had estimates from the Treasury of between $124 million and $310 million in the first year; but this figure assumes a certain size and likely population limit for the zones; limitations, I might add, that are not mandated in the bill.

So, I commend the administration for at least launching the concept. And, perhaps, with the assistance of all those who are sincerely interested at the State, local and Federal levels, we can fashion a package that will be meaningful.

Thank you, Mr. Chairman.

[The prepared statement of Senator Dole follows:]

STATEMENT OF SENATOR DOLE ON ENTERPRISE ZONES

Mr. Chairman, I know the members of the Finance Committee appreciate having this early opportunity to review the Reagan administration's proposal to establish enterprise zones as a means of experimenting with new techniques for redeveloping depressed areas. President Reagan announced his enterprise zone initiative as recently as March 23, and today marks the first time the administration will have testified to Congress on its proposal. I am pleased to join with you and the other Subcommittee members in welcoming Secretary Pierce, Assistant Secretary Chapoton, Assistant Secretary Brady and the other witnesses who will discuss the goals the President is seeking to achieve here.

This, of course, is not the first time this Subcommittee has examined the enterprise zone concept. Hearings were held last July 13 and 16, in the midst of the tax cut debate, on S. 1310, the bill introduced by Senator Chafee and Senator Boschwitz. At that I indicated that there were many questions that needed to be addressed before we could implement an enterprise zone program, keeping in mind the goals of minimizing administrative complexity and encouraging Federal, State, and local cooperation to make this idea work.

SHAPING A PROPOSAL

I think it is fair to say that progress has been made since last July in dealing with some of the questions raised at that time. The discussions and analysis that have gone into developing the administration's proposal have, at least, ruled out some approaches and ruled in others, so that the range of questions we need to address has been narrowed. For example, the administration proposal limits the number of zones to 25 a year for three years: there is a clear intention to use this proposal to demonstrate a new approach to stimulating development rather than to open the floodgates before we have a chance to test the idea. Further, the administration bill, S. 2298, sets up a process for cooperation between Federal, State, and local officials; it rules out refundability in its tax provisions; and it avoids tampering with the minimum wage or any statutorily imposed regulatory requirements.

MORE TO BE DONE

Mr. Chairman, with an administration proposal before us the task ahead of us does become clearer. Some decisions have been made, but in some cases a decision raises new questions. For example, to support job-creation in enterprise zones, the administration proposes three employment tax credits, two available to the employer and one for the employee. The effectiveness of such credits, as in the case of the targeted jobs credit, certainly is not proven. We will have to consider whether an effective wage subsidy can be devised through the tax code, or whether another approach might be better.

Some general concerns about the enterprise zone concept also remain, and they will have to be discussed. We cannot be sure that a particular proposal will ensure new economic activity as opposed to channeling existing activity to certain areas: but we should do our best to find what provisions are most likely to achieve that result. Similarly, no package of tax incentives is guaranteed to attract business to an area plagued by poverty, a deteriorating infrastructure, and in many cases high crime rates. But no one, presumably, is looking for guarantees—the goal is to assemble the most meaningful set of tools for fostering private development in areas where government subsidies and regulations have failed. If we keep this project in perspective, we are more likely to reach some agreement.

Still, the questions are many, and they may not be all that easy to resolve. What, for instance, will happen to businesses that already exist on the periphery of an area designated as a zone? Will they all move into a zone, leaving a no-man's land, or will they stay put despite a competitive disadvantage relative to zone businesses? For purposes of the tax provisions, how should we treat businesses engaged in transportation or moving—how much of their business is really "zone business"? Nor is it clear how a strong a package of State and local incentives will be adequate to win HUD approval, or to generate significant economic activity. Local tax abatement has had mixed results as a tool for attracting development, and it might be a mistake to expect too much from that factor alone. At the Federal level, we have already provided very substantial tax relief for business—the additional investment credit, employment credits, and capital gains relief provided by this bill may not be decisive factors for companies already benefiting from ACRS and other tax incentives provided last year.

In addition, we will need to give some attention to ensuring that commitments undertaken by all parties in creating a zone are kept. Under the bill, the State and locality are to provide assurances to HUD that their commitments will be fulfilled; HUD can revoke a zone designation for noncompliance; and preference is given to proposals with the most "effective and enforceable" guarantees. Whether this is enough is a real question, and it leaves open the matter of how zone authorities may deal with businesses that accept their concessions and then withdraw from the zone.

Finally, the cost of this proposal is not certain. The Treasury Department estimates a cost of between $124 million and $310 million in the first year—but this figure assumes a certain size and likely population limit for the zones, limitations that are not mandated by the bill. It might be useful to have a range of estimates available, and the assumptions underlying those estimates.

The Reagan administration has, at least, gotten the ball rolling on this proposal. It remains to be seen how fast we can move: this Congress, and the Finance Committee in particular, have a heavy legislative agenda for the year. Nor is there any indication that the House will take up the legislation in the near future, and that is where revenue measures have to originate. But the first job is to resolve the remaining questions to see if we can generate a consensus proposal. Then we can have a better sense of the prospects for passage.

Senator CHAFEE. Thank you very much, Mr. Chairman. We appreciate your attending here this morning for such time as you can give to this matter. We know you have long been interested in it.

We would like to start off with two of our colleagues who have long been interested in this matter. Senator Heinz is here.

Senator, if you could step right up, right next to the Secretary. Senator, we know you have been active in this area for a long time. You have had legislation of your own in, and thus we would look forward to your statement.

Senator HEINZ. Mr. Chairman, thank you very much. I will be brief, and I would ask unanimous consent that my prepared text be put in the record in full.

First, I would like to compliment you, Mr. Chairman, on holding these hearings and on your interest in enterprise zones. The Chafee-Boschwitz bill is an excellent bill. The interest you have taken in this goes back many years, and I know you share the interest that so many of us have in trying to get an enterprise zone bill that works.

I think Senator Dole's comments need to be taken quite seriously. Any enterprise zone bill—and I have introduced one, the President has one, the original Kemp-Garcia is another approach—all of them have had rough edges. Each successive draft of those bills has been major in terms of its improvements.

I was very pleased, as I imagine you were with respect to your legislation, to see that the President's bill borrowed liberally from your bill, from my bill, and from previous bills. In my judgment it represents an improvement on anything that had gone before. I hope the work of the committee will continue that progress in shaping an enterprise zone bill that will in fact meet all of the tests that we ask of it. I think it is vital that we do so in order that we have legislation that will not be unfair to those people who are not in the zone but that will give positive hope to those who are going to be in such zones.

There are just three things I want to say in terms of areas where we might seek to improve what the President has sent us. And I make these comments notwithstanding the fact that I believe the President has sent us a thoughtful, rather comprehensive work product.

I am honored and privileged to be sitting here next to Secretary Pierce who will have the lion's share of the responsibility, not only for helping us work out the various improvements and details but who will have the lion's share of the responsibility in making very difficult judgments when we get around to designating enterprise zones and making the entire program work.

Sam, you had a tough job to begin with, and I can see it's not going to get any easier.

Mr. Chairman, my thoughts on what we might do are this:

First, coming as I do from a State which has many rural areas, and noting as I do that only 25 zones are going to be designated per year, and observing that it is the Secretary of Housing and Urban Development that will be making these judgments, I hope we can structure the legislation in a way where we can encourage the selection not just of urban enterprise zones—important and deserving as they are—but to have a sufficient number; and I'm thinking that perhaps we should raise the number from 25 per year to a somewhat larger number, to permit a sufficient number of rural area designations as well.

If you want one example, quickly, in Pennsylvania we have a five or six county area known as "The Southern Allegheníes." It includes such areas as Johnstown, Pa., and surrounding counties. The unemployment in that six-county area is close to 14 percent—higher by far than our State average. It is, nonetheless, an area with an abundance of human and natural resources. And I for one would like to see an area like that be able to compete on equal terms with New York City or Providence, R.I., or Los Angeles for designation.

Second, and this is an area which I have tried to address in my legislation, I am not sure that in spite of best efforts to do so the President's legislation gives enough of an incentive, enough of a tax break up front, particularly to small employers who would seek to locate or expand in zones.

One of the reasons I put into my legislation an expanded subchapter-S approach whereby investment tax credits accelerated depreciation—which in my bill I accelerated even beyond ACRS, Mr. Chairman—was that I wanted individual companies, individual entrepreneurs, and individual investors to be able to get an immediate flowthrough of tax benefits in the year in which those investments were made.

That doesn't mean I am opposed to the liberalized capital gains treatment in the President's bill, but that will come only at the end of a successful investment. What we want, it seems to me, is to encourage investment right up front.

So I urge, Mr. Chairman, the committee to pay particular attention to that.

Finally, I think we should look at the extent to which we judge the applications of enterprise zone areas, not based on some absolute scale that the State or local government is going to be able to provide 500 dollars' worth of benefits per potential employee but what each area can do relative to its resource base.

If we get Houston—and there are some poor areas of Houston—into a bidding war with Providence or Pittsburgh or Philadelphia, Houston will win; it has a larger tax base. Providence, R.I., and Philadelphia don't have a tax base per capita that can compare.

So, therefore, I want to be sure that when there is a competition that the relative contribution is judged in the way where we take into account that what is available to the city fathers, to the States involved, will be considered without prejudice; and that we will not, when Secretary Pierce and others make judgments about enterprise zones, simply allow them to be designated for those areas that are already well-to-do to begin with.

Those, Mr. Chairman, are my three most important thoughts. I have many others. I won't take your time or Secretary Pierce's time.

In closing, let me just thank you for your great leadership in this area. I look forward to working with the committee—I might add, on the committee—to fashion a bill that will work for all Americans.

Thank you very much.

Senator CHAFEE. Well, thank you very much, Senator, and we appreciate all the thought that you have given not just to these three suggestions but in your legislation and your constant attention to this whole matter. We look forward to your input as we go along through this matter.

Your suggestions about the rural areas I'm sure struck home with the chairman of the full committee. He nodded enthusiastically at that first point.

So, thank you.

[The prepared statement follows:]

STATEMENT BY SENATOR JOHN HEINZ

I am extremely pleased to testify before you today on the subject of Enterprise Zone legislation and in particular the important initiative in this area recently taken by President Reagan and his Administration.

I commend the Administration for its efforts to distill into a single bill the distinguished efforts of several Senators. My colleagues Senators Chafee, Boshwitz, Danforth, Riegle and I have debated the issue at length and have developed strong views and independent proposals in this area.

The Administration's efforts are an important new initiative. It will contribute greatly both to the debate and to the efforts to transform this concept into a fertile reality.

I would like to center my remarks upon two critical considerations. Whatever proposal is developed we must insure that it is both fair and effective.

The goal of this legislation is to foster an environment in which the dormant potential of an economically distressed area can be revitalized and attain a level of self sustaining growth. That potential lies at the heart of every city, town or village in this great nation. Enterprise Zone legislation is not a panacea for all our social or economic problems, yet it holds great promise for communities of every size, and description in every region of the country.

We must not forget that there is a richness of diversity among these communities. There are at least 10,000 economically distressed areas in this country. There will be a richness to the variety of responses among these communities to the incentives of a Zone, each response based upon the unique potential of that community.

In the initial stages of the Zones program only a limited number of "pilot" zones will be created. In assessing the areas which would benefit from Zone designation, we must not let the highly visible problems of our large cities overshadow the significant contribution a Zone designation would have to efforts to revitalize small towns and rural areas. There is much to be gained and much to be learned by tapping the resolve and creativity of these people. Fairness and common sense demand that Congress ensure a broad participation by communities of all sizes.

We must also be sure that the competitive nature of the application process the Administration has proposed does not discriminate against those areas that are most deeply in need. A city like Houston, with its growing economy and healthy, expanding tax base can afford to make pledges that are far larger in absolute terms than a city with greater economic distress and a deteriorating tax base. When the Secretary of Housing and Urban Development evaluates applications it is vital that the consessions and contributions a jurisdiction has pledged to provide in support of an enterprise zone in terms of local tax relief or increase public services be judged against the relative ability of that government to make sacrifices.

To simply achieve an Enterprise Zone Program that is fair is not enough. It must also be effective. That will require starting many businessmen within Zones from scratch.

The National Federation of Independent Businesses found in its survey of Small Business in America's Cities that lack of capital was the most significant problem facing small businesses. Tax incentives should be directed at the vulnerability by fostering infusions of new capital and reducing the drain on existing capital.

When growing companies generate little taxable income, non-refundable credits do not provide needed cash infusions. Reductions in the capital gains tax on holdings within the Zone increase the rewards for being successful but do not decrease the risk or substantially address the need for capital. A tax benefit that can only be taken in the future means nothing to a company that needs capital today.

Zones will only be effective if problems that face the community as a whole are also overcome—problems like youth employment training, lack of day care, housing abandonment. It is, perhaps, a strong merit of the Administration's proposal that the designation process would elicit firm pledges by nominating jurisdictions to target substantial resources toward tackling such problems. It is equally important to ensure that existing programs, not under the direct authority of nominating jurisdictions, continue the current support for areas designated as Zones.

I would like to make three recommendations. First, a sufficient number of Zones should be designated during the initial three years of the Program to ensure a broad participation among our nation's richly diverse communities and, to the extent necessary, a number of designations should be targeted at towns, villages and rural areas.

Secondly, the law must carefully direct that for Zone status. In the evaluation of applications the uppermost criteria must be the amount of good that can be done for those most deeply in need and the relative sacrifice nominating jurisdictions must make to carry the burden of the concessions they pledge.

Thirdly, in recognition of a growing business' need for capital, emphasis should be placed on tax incentives that yield immediate benefits. An effective proposal would not need to be more expensive than the Administration's proposal. The costs of increasing immediate tax benefits to investors could be offset by dollar-for-dollar reductions of deferred benefits. For example, the proposed favorable treatment of the capital gain on Zone property could be eliminated in favor of a flow through of tax benefits to investors in a Zone business during the early years of the investment.

What this country needs is more people gainfully employed, producing goods and paying taxes instead of being reduced to a reliance in unemployment benefits and welfare. I believe the Enterprise Zone Program, amended as I have suggested, will achieve this.

I thank you for the opportunity to testify.

Senator DOLE. I think Senator Danforth has expressed an interest in this, too.

Senator CHAFEE. Yes; that is correct. He has had a bill in in that area.

Now, I do not see Senator Boschwitz here. He has a statement. If he doesn't come later we will put the statement in the record for him and have it follow right after Senator Heinz.

Mr. Secretary, we welcome you here, and why don't you proceed? You have a statement, I believe, and obviously we will have some questions. We are glad you are here and appreciate what you have done.

STATEMENT OF SAMUEL R. PIERCE, JR., SECRETARY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Secretary PIERCE. Thank you very kindly.

I would like to make some comments and then submit a more detailed statement for the record, if that pleases you, Mr. Chairman.

Senator CHAFEE. Fine. That's excellent.

Mr. Chairman, I am pleased to be here this morning to testify on behalf of the administration's proposed enterprise zone program. I am particularly happy to see the rapid commencement of these hearings. I take this as evidence that Congress views the need for establishing and implementing this program with the same urgency that the administration does.

On March 23d President Reagan sent to Congress proposed legislation to create the enterprise zone program. This is a high priority program for the President and for all the rest of us in the administration who care deeply about the conditions of our communities.

This new program would be an experimental free market initiative for addressing the problems of economic distress in inner cities and rural towns. It is no panacea but it is definitely worth trying.

The underlying concept of enterprise zones is to create a productive free market environment in depressed areas through relief from taxes, regulations, and other Government burdens on economic activity. The removal of these burdens will create and expand economic opportunity within the zone areas, allowing private sector firms and entrepreneurs to create jobs and expand economic activity within those areas.

Enterprise zones are based on an entirely fresh approach to promoting economic growth in distressed communities. The old approach relied heavily on Government subsidies and central planning. The new enterprise zone approach is based on removing Government barriers which are preventing people from creating, producing, and earning their own wages and profits.

Because the program is based on the concept of removing Government burdens rather than on providing Government subsidies it requires no appropriations. States and cities will still have the option of allocating their discretionary Federal funds for their enterprise zones if they desire, or to appropriate additional funds on their own for such zones.

The administration program will involve efforts by all three levels of Government, Federal, State and local, to remove Government burdens and provide other contributions to the enterprise zone areas. The State and local contributions are critical to this effort and will, in fact, probably make the difference as to whether individual zones succeed or fail.

The enterprise zone program has two basic objectives: To create jobs, and to redevelop and revitalize the Nation's economically depressed areas. The intent behind the program is to stimulate new economic activities within the zones that would not have otherwise occurred at all, anywhere, rather than to encourage existing outside activity to relocate into the zones. The program is intended not to stimulate a particular kind of business but rather to let the market decide what activities should take place in the zones by means of a balanced set of incentives for a broad range of economic activities and businesses.

The comprehensive enterprise zone program includes four basic elements. The first is tax reduction at the Federal, State, and local levels to lessen this obvious burden on economic activity.

The second is regulatory relief at the Federal, State, and local levels to reduce burdens which can be equally costly and which otherwise inhibit entrepreneurial efforts.

The third is improvement of local municipal services such as increased police protection and including experimentation with private sector alternatives for providing those services.

The final element is involvement in the program by neighborhood organizations. These organizations can contribute much to the improvement of enterprise zone neighborhoods and can insure that zone residents have a stake in the economic success of the zones.

The initial designation and establishment of each zone will depend on local leadership and initiative. To obtain the Federal incentives for enterprise zones the State and local governments must first nominate the zones within eligible areas as defined by the Federal legislation.

Eligible areas will include all UDAG-eligible areas which have recently experienced significant unemployment, poverty, or population loss. Based on these criteria there will be more than 2,000 cities and counties with enterprise zone eligible areas, of which about 1,500 are smaller communities, under 50,000 in population.

After State and local nominations, these Governments will apply to the Department of Housing and Urban Development for the Federal designation which will allow the Federal incentives to apply to their zones.

Before such an application can be made, a zone nomination must have been approved by both the governing State and local jurisdictions. Both such jurisdictions must also provide incentives and contributions. The Department will be authorized to designate up to 25 zones in each of 3 years for the application of the Federal incentives.

The Federal tax incentives to apply within the zones are described in detail in the legislation and accompanying supporting documents. They include tax reductions for employers, employees, entrepreneurs, investors, and lenders. They include incentives for capital investment, for hiring workers, particularly disadvantaged workers, for increasing work effort, for providing loans to enterprise zone businesses, and for starting and building up new businesses. They include reductions in corporate income taxes, individual income taxes, capital gains taxes, and tariffs. Within these zones the most comprehensive and dramatic program of Federal tax relief ever attempted will be provided.

On the regulatory side, State and local governments will be authorized to request relief for their approved zones from any Federal regulation not specifically imposed and spelled out by statute. This special authority would expressly not apply, however, to any regulations designed to protect any person or group against discrimination because of race, color, religion, sex, marital status, national origin, age, or handicap. It would also expressly not apply to regulations affecting public safety or health, including environmental health.

The minimum wage law, for example, would not be included in the waiver authority because it is specifically imposed and spelled out by statute.

While these Federal incentives are substantial, strong State and local contributions to the zones will be necessary for the program to succeed. These contributions can be from each of the four basic categories—tax relief, regulatory relief, improved local services, and private sector neighborhood organization involvement. More traditional redevelopment efforts such as job training, seed money, minority business assistance, and infrastructure grants can also be contributed to the zone by State and local governments.

The responsibility for starting and developing the program is consequently placed where it belongs—at the State and local levels. The program thus represents creative federalism at its best, establishing a flexible and locally adaptable partnership among all three levels of government.

Concern has been expressed that since more businesses generally have low profitability and low tax liability they will not be helped much by the enterprise zone program because of its reliance on tax incentives. That concern fails to recognize that the enterprise zone initiative is not just a Federal tax incentive program, it involves a comprehensive across-the-board effort to remove all types of government burdens on economic activity at the Federal, State, and local levels.

Regulatory relief will help small businesses, since regulations impose costs which businesses must bear regardless of whether they make a profit. Such relief will be particularly important to small businesses.

Improved local services through the introduction of competition and private sector providers will also help small businesses. Such improved services will allow businesses to operate more efficiently and lower their costs.

Many of the Federal tax incentives will help small businesses, also. The capital gains elimination will help small entrepreneurs who start and build up new businesses to receive the full value of their labor when they sell out.

The provision for the continuation of IBD's in enterprise zones will help small businesses obtain startup capital. This incentive, in particular, does not rely on the tax liability of the small businesses which is likely to be minimal, but rather on the more substantial tax liability of the lender, and consequently it should be effective in aiding small businesses.

Tax relief in general should also help to encourage the establishment of small businesses in enterprise zones. All small entrepreneurs start businesses expecting to make a profit at least some time within a 20-year period, which is the time for which the enterprise zone may last.

Concern has also been expressed about whether the proposed program sufficiently addresses the greatest problem faced by entrepreneurs attempting to start small businesses—obtaining the necessary startup capital. Most new businesses are begun with the personal savings of the entrepreneur or savings from family or friends. The chief reason why these small investors start and invest in a new business is to obtain the long-run profits which they expect from the enterprise. The tax reductions and other elements of the enterprise zone program will increase these expected long-term profits. These elements will also induce larger financial institutions to lend money to enterprise zone businesses. The program thus should result in a substantial increase in front-end capital for viable businesses which have reasonable profit potential over the long run.

Moreover, since IDB's will continue to be available for small businesses within enterprise zones, they in effect would eliminate taxation on the interest received by a lender to a small enterprise zone business.

Sufficient capital for new businesses can come only from the private sector. Federal business loans currently account for only 3 percent of all startup capital. Providing such Federal loan assistance as part of the enterprise zone program would run counter to the program's theme of removing Government burdens rather than deciding bureaucratically who should receive direct grants or subsidies. The market, in the final analysis, is the best judge as to which businesses should receive loans.

The legislation under consideration today is based on the pathbreaking work of many Members from both sides of the aisle who offered enterprise zone bills in prior sessions of Congress. We commend these pioneering efforts and anticipate that these innovative individuals will work for early bipartisan passage of this legislation.

Mr. Chairman, more than Government expenditures and subsidies, residents of economically depressed areas need opportunities. This is the focus of the enterprise zone program. The program seeks to identify and remove Government barriers to entrepreneurs who are capable of creating jobs and economic growth. It aims to draw out and build upon the latent talents and abilities already present among the people in our Nation's most depressed areas. This bold, new concept deserves a chance to work.

Thank you very much.

[The prepared statement follows:]

TESTIMONY OF SAMUEL R. PIERCE, JR., SECRETARY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. Chairman, I am pleased to be here this morning to testify on behalf of the Administration's proposed Enterprise Zone program. I am particularly happy to see the rapid commencement of these hearings. I take this as evidence that Congress views the need for establishing and implementing this program with the same urgency that the Administration does.

On March 23, President Reagan sent to Congress proposed legislation to create the Enterprise Zone program. This is a high priority program for the President and for all the rest of us in the Administration who care deeply about the conditions of our communities.

This new program would be an experimental, free-market initiative for addressing the problems of economic distress in inner cities and rural towns. It is no panacea, but it is definitely worth trying.

BASIC CONCEPT AND PURPOSE

The underlying concept of Enterprise Zones is to create a productive, free-market environment in depressed areas through relief from taxes, regulations and other government burdens on economic activity. The removal of these burdens will create and expand economic opportunity within the zone areas, allowing private-sector firms and entrepreneurs to create jobs and expand economic activity within these areas.

Enterprise Zones are thus based on an entirely fresh approach to promoting economic growth in distressed communities. The old approach relied heavily on government subsidies and central planning. A prime example was the Model Cities Program of the 1960s, which concentrated government programs, subsidies and regulations in specific, depressed urban areas. Instead of concentrating government within these areas, the new Enterprise Zone approach is based on removing government barriers which are preventing people from creating, producing and earning their own wages and profits. In this respect, Enterprise Zones are the direct opposite of the Model Cities Program of the 1960s.

Because the program is based on the concept of removing government burdens rather than providing government subsidies, it requires no appropriations, at least at the Federal level, except for necessary administrative expenses. States and cities will still have the option of allocating their discretionary Federal funds such as CDBG and UDAG for their Enterprise Zones if they desire, or to appropriate additional funds on their own for such zones.

Enterprise Zones require more than just Federal action, and more than merely tax relief. The Administration program will involve efforts by all three levels of government—Federal, State and local—to remove government burdens and provide other contributions to the Enterprise Zone areas. The State and local contributions are critical to this effort, and will, in fact, probably make the difference as to whether individual zones succeed or fail. In keeping with the Administration's policy of Federalism, State and local governments will have broad flexibility to develop contributions to their zones which are most suited to local conditions, local needs and local preferences.

The Enterprise Zone program has two basic objectives. The first is to create jobs within the Nation's economically depressed areas, particularly jobs for disadvantaged workers. The second is to redevelop and revitalize the geographic zone areas themselves.

The intent behind the program is to stimulate new economic activity within the zones that would not have otherwise occurred at all, anywhere, rather than to encourage existing outside activity to relocate into the zones. Our own investigations indicate that given the costs of relocation and the tendency of existing firms to be structured to take advantage of the opportunities at their present locations, it is unlikely that currently existing businesses will relocate into Enterprise Zones. However, it is quite possible that some entrepreneurs considering the establishment of entirely new businesses and some existing firms considering major expansions will locate their new facilities within the zones, even though they would have gone ahead with these projects elsewhere in the absence of the program. While relocation in this sense is not as purely beneficial as the stimulation of entirely new activity, bringing such economic development to depressed areas has important social benefits and would, therefore, still be an advantageous result of the program.

In addition, the program is intended not to stimulate a particular kind of business, but rather to let the market decide what activities should take place in the zones. While the Federal tax incentives are skewed towards labor-intensive businesses and jobs for disadvantaged workers, the program generally is meant to include a balanced set of incentives for a broad range of economic activities and businesses. The program is most likely to be effective if no potential enterprise is excluded from participation: large or small, service or industrial, housing or commercial.

Finally, the Administration intends that the current residents of the zone benefit from the economic improvement which is expected to take place there. The program includes features designed to help ensure this result.

THE ELEMENTS OF THE ENTERPRISE ZONE PROGRAM

The comprehensive Enterprise Zone program includes the following four basic elements, all of which are equally necessary and equally important:

The first is tax reduction at the Federal, State and local levels to lessen this obvious burden on economic activity.

The second is regulatory relief at the Federal, State and local levels to reduce burdens which can be equally costly and which otherwise inhibit entrepreneurial efforts.

The third is improvement of local municipal services, such as increased police protection, and including experimentation with private-sector alternatives for providing those services. Experience has shown that relying on private alternatives can save taxpayers substantial sums while at the same time significantly improving services. This element addresses the need to improve the civil environment in depressed areas before businesses will locate there.

The final element is involvement in the program by neighborhood organizations. These organizations can contribute much to the improvement of Enterprise Zone neighborhoods and can also ensure that zone residents have a stake in the economic success of the zones.

It is the combination of all these elements taken together that will create the environment needed to revitalize our Nation's economically depressed areas. Clearly, this is not just a tax incentive program.

PROGRAM STRUCTURE

The initial designation and establishment of each zone will depend on local leadership and initiative. To obtain the Federal incentives for Enterprise Zones, the State and local governments must first nominate the zones within the eligible areas as defined by the Federal legislation.

This city-State partnership was included because of our strong belief that the success of an enterprise zone will depend upon the ability of cities and States to work together to reduce taxes, regulations, and other government burdens that inhibit economic expansion and to enlist commitments from the private sector to provide jobs, job training, and technical, financial or other assistance to employers, employees and residents of the zone. Since most communities are creatures of State government and receive their authority and powers from the State, local-State cooperation will often be necessary to reduce taxes and regulations and relax other restraints on economic activity at the local level.

Eligible areas will include all areas which have recently experienced significant unemployment, poverty or population loss and are located within UDAG eligible areas. Based on these criteria there will be more than 2,000 cities and counties with Enterprise Zone eligible areas, including many in rural areas.

Concern has been expressed about the eligibility of rural areas as Enterprise Zones. In recognition of this concern, let me stress emphatically that the legislation contains no bias in favor of either large or small cities in this experiment. Suggestions have been made that seperate set-asides be provided for rural areas. To do this would be contrary to the Enterprise Zone concept itself, and would also distort the competitive nature of the program.

Many rural areas will satisfy the eligibility criteria for Enterprise Zones. Of the 2,000 cities and counties eligible for an Enterprise Zone designation, approximately 1,500 of these are small cities under 50,000 in population. State and local governments can nominate zones in these areas and compete for Federal designation along with zones nominated in larger cities. There will be no special preference in this process for urban or rural areas.

Those nominated zones which best satisfy the stated criteria will receive Federal designation, regardless of whether they are urban or rural. I firmly believe that small cities, as well as large cities, have the innovative capacity and commitment to civic renewal necessary to meet the requirements to be designated as Enterprise Zones and that we will see a broad cross-section of cities qualify and be designated as Enterprise Zones.

After State and local nomination, these governments will apply to the Secretary of HUD for Federal designation, which will allow the Federal incentives to apply to their zones. Before such an application can be made, a zone nomination must have been approved by both the governing State and local jurisdictions. Both such jurisdictions must also provide incentives and contributions.

Federal designation of nominated zones would not be automatic or routine. Rather, the Secretary will evaluate the various applications on a competitive basis against each other, choosing the best applications for the limited number of Federal designations available each year. The key criterion in this competitive process will be the quality and strength of the State and local incentives to be contributed to the zones, giving primary emphasis to incentives or contributions consistent with the overall Enterprise Zone theme of creating an open-market environment through the removal of government burdens and taking into account fiscal ability to provide tax relief. Other important factors will also be considered.

The Federal posture towards the elements in the State and local contribution packages will be highly flexible. The Secretary of HUD will not insist on any particular item of tax or regulatory relief, for example, or privatization of a specific service. A weakness of incentives in one areas, such as tax relief, could be offset by greater strength in another area, such as regulatory relief.

The Secretary will be authorized to designate up to 25 zones in each of three years for the application of the Federal incentives. The actual numbers designated will depend on the number and quality of the applications. Each Enterprise Zone will last for the period chosen by the nominating State and local governments. The Federal incentives will apply to an approved zone for this entire period, up to a maximum of 20 years plus a four year phaseout period.

THE FEDERAL INCENTIVES

The Federal tax incentives to apply within the zones are described in detail in the legislation and accompanying supporting documents. They include tax reductions for employers, employees, entrepreneurs, investors and lenders. They include incentives for capital investment, for hiring workers, particularly disadvantaged workers, for increasing work effort, for providing loans to Enterprise Zone businesses and for starting and building up new businesses. They include reductions in corporate income taxes, individual income taxes, capital gains taxes and tariffs. Within these zones, the most comprehensive and dramatic program of Federal tax relief ever attempted will be provided.

On the regulatory side, State and local governments will be authorized to request relief for their approved zones from any Federal regulation not specifically imposed and spelled out by statute. Federal regulatory bodies will be authorized to weigh these requests under Congressionally mandated standards, and to relax the regulations when it is in the public interest to do so, given the goals of the Enterprise Zone program.

This special authority would expressly not apply, however, to any regulations designed to protect any person or group against discrimination because of race, color, religion, sex, marital status, national origin, age, or handicap. It would also expressly not apply to any regulation whose relaxation would be likely to present a significant risk to the public safety or health, including environmental health. The minimum wage law, for example, would not be included in the waiver authority because it is specifically imposed and spelled out by statute.

It should be emphasized that there will be no authority for any Federal regulatory relief within an Enterprise Zone without a request for such relief from both the State and local governments governing the zone.

STATE AND LOCAL ROLE

While these Federal incentives are substantial, strong State and local contributions to the zones will be necessary for the program to succeed. These contributions can be from each of the four basic categories noted earlier: tax relief, regulatory relief, improved local services, and private-sector, neighborhood organization involvement. More traditional redevelopment efforts, such as job-training, seed money, minority business assistance and infrastructure grants can also be contributed to the zone by State and local governments.

Consistent with the Administration's policy of Federalism, the Federal Government will not dictate to State and local governments what they must contribute to the zones. The program is designed to encourage creative and innovative experiments by State and local governments within the zone areas. The program retains the flexibility for these governments to marshal their resources and tailor their contributions to suit local needs and preferences.

The responsibility for starting and developing the program is consequently placed where it belongs—at the State and local levels. The program thus represents creative Federalism at its best, establishing a flexible and locally adaptable partnership among all three levels of government.

State and local governments have already exhibited remarkable enthusiasm for the Enterprise Zone idea. Eight states plus the District of Columbia have already passed Enterprise Zone bills and 28 additional states are currently considering 67 such bills. All across the country task forces are at work preparing possible Enterprise Zone proposals.

State and local governments have also already displayed considerable creativity in these efforts. In Kentucky, the legislature has passed a bill providing for the establishment of Neighborhood Enterprise Associations, an idea pioneered by the Sabre Foundation here in Washington. These associations would be incorporated bodies of residents in Enterprise Zone neighborhoods. Unused State and local property within the association's State and local area would be leased to the association for nominal amounts, and the association would be exempt from State and local taxes. Providing zone residents with this equity interest will enable them to participate in the economic success of the zone and develop a greater sense of commitment by the residents to their neighborhoods.

The Administration would encourage the development and implementation of creative State and local initiatives. Enabling zone residents to obtain interests in the zone will help to channel to them some of the economic benefits of the zone. The skewing of the Federal tax package towards the hiring of disadvantaged workers will provide them with new job opportunities within the zone. The general creation of economic opportunity in proximity to zone residents which will result from the program will also make it easier for them to work their way into the mainstream of the economy.

State and local contributions to the zones need not be costly. Regulatory relief, service improvements through privatization, and private sector involvement entail no net budgetary cost.

Even the cost of State and local tax relief should be modest because weak economic activity is weak or non-existent in potential Enterprise Zone areas. If the program is successful in stimulating new economic activity, tax relief losses will be substantially offset through increased revenues from the new activity and reduced expenditures due to the employment of individuals formerly receiving government assistance.

The role we are asking cities and States to play is not necessarily a new one. Many cities and States, throughout this Nation, should be applauded for the individual and cooperative efforts they have undertaken in recent years to meet local and statewide economic development needs. A variety of incentives have been developed which parallel the basic thrust of this legislation. However, Enterprise Zone legislation takes us one step further by targeting State and local incentives, in addition to Federal incentives, for distressed areas of our country. The fact that 36 States and hundreds of cities are now working together to design State-administered Small City Community Development Block Grant programs demonstrates that such partnerships are real and can work.

SMALL BUSINESSES

Concern has been expressed that since small businesses generally have low profitability and low tax liability they will not be helped much by the Enterprise Zone program because of its reliance on tax incentives.

That concern fails to recognize that the Enterprise Zone initiative is not just a Federal tax incentive program. It involves a comprehensive, across-the-board effort to remove all types of government burdens on economic activity at the Federal, State and local levels.

Regulatory relief will help small businesses since regulations impose costs which businesses must bear regardless of whether they make a profit. Such relief will be particularly important to small businesses. Large businesses can generally absorb the costs of regulation more easily, by such means as spreading the costs over more units of production, and are also better able to pass the imposed costs on to customers. Small businesses do not have these advantages.

Improved local services, through the introduction of competition and private sector providers, will also help small businesses. Such improved services will allow businesses to operate more efficiently and lower their costs.

State and local reduction of taxes which apply regardless of profitability can further help small businesses. These include property taxes and sales taxes.

Many of the Federal tax incentives will help small businesses also. The capital gains elimination will help small entrepreneurs who start and build up new businesses to receive the full value of their labor when they sell out.

The provision for the continuation of IDBs in Enterprise Zones will help small businesses obtain start-up capital. This incentive in particular does not rely on the tax liability of the small businesses, which is likely to be minimal, but rather on the more substantial tax liability of the lender, and consequently it should be effective in aiding small businesses.

The extension of the operating loss carryover and the carryover of unused Enterprise Zone credits will allow small businesses which are successful to eventually receive the benefit of the zone incentives. The abatement of tariffs and import duties through the designation of Foreign Trade Zones in Enterprise Zones will also help small businesses, since these taxes are again borne regardless of the profitability of the firm.

Tax relief in general should also help to encourage the establishment of small businesses in Enterprise Zones. All small entrepreneurs start businesses expecting to make a profit at least sometime within a 20 year period, which is the time for which an Enterprise Zone may last. Tax relief will increase this expected profit, and therefore should induce more small businesses to start in Enterprise Zones.

In addition, the Enterprise zone incentives will encourage large businesses to locate branches within the zone. These branches will provide business opportunities for small, spin-off firms.

FRONT-END CAPITAL

Concern has also been expressed about whether the proposed program sufficiently addresses the greatest problem faced by entrepreneurs attempting to start small businesses—obtaining the necessary start-up capital.

Most new businesses are begun with the personal savings of the entrepreneur or savings from family or friends. Seventy-five percent of all new businesses start without using any outside debt or equity. Eighty-nine percent of all start-up capital for new businesses comes from personal savings.

The chief reason why these small investors start and invest in a new business is to obtain the long-term profits they expect from the enterprise. The tax reductions and other elements of the Enterprise Zone program will increase these expected long-term profits. Consequently, the program should result in an increase in the private savings available for front-end investment in small businesses in Enterprise Zones.

These elements will also induce larger financial institutions to lend more money to Enterprise Zone businesses. This is because these elements will increase the profits and cash flow of these businesses out of which such loans are to be repaid. With higher profits and cash flow, the risk of such loans is reduced, and financial institutions are more likely to make them.

The program thus should result in a substantial increase in front end capital for viable businesses which have reasonable profit potential over the long run. These incentives, of course, will not do any good for firms suffering chronic losses without any foreseeable profit prospects. The Enterprise Zone program is intended to attract healthy, economically sound, profitable businesses to the zones which can serve as the basis for long-term economic growth.

Moreover, since IDBs will continue to be available for small businesses within Enterprise Zones, they in effect would eliminate taxation on the interest received by a lender to a small Enterprise Zone business. This would increase the return to the lender on such loans and, therefore, should increase the availability of such loans.

Sufficient capital for new businesses can come only from the private sector. Federal loan assistance to businesses currently accounts for only three percent of all start-up capital. Providing such loan assistance as part of the Enterprise Zone program would run counter to the program's theme of removing government burdens rather than deciding bureaucratically who should receive direct grants or subsidies. Moreover, it is doubtful that the government, rather than the market, can efficiently judge which businesses should receive loans.

CONCLUSION

The legislation under consideration today is based on the path-breaking work of many members from both sides of the aisle who offered Enterprise Zone bills in prior sessions of Congress. We commend these pioneering efforts and anticipate that these innovative individuals will work for early bipartisan passage of this legislation.

Mr. Chairman, more than government expenditures and subsidies, residents of economically depressed areas need opportunities. This is the focus of the Enterprise Zone program. The program seeks to identify and remove government barriers to entrepreneurs who are capable of creating jobs and economic growth. It aims to draw out and build upon the latent talents and abilities already present among the people in our Nation's most depressed areas. This bold, new, concept deserves a chance to work.

Senator **Chafee**. Thank you, Mr. Secretary, for that very fine statement. You have been a prime mover in this effort, and the members of this committee look forward to working with you as we proceed.

I have a question regarding the State approval that is required for an application. We have a panel of mayors that are going to appear before us shortly, and I suspect they are going to object to that provision. They are going to feel that, one, they might run into a Governor who is inamicable to their city or community; it may be that the bureaucracy in the State is so lethargic that nothing can be accomplished; there will be a series of reasons, I suspect, that the mayors might present as to why they should be required to go through and get the imprimatur of the State before they can submit an application to you. Could you give us your rationale for that?

Secretary PIERCE. Well, we have considered that problem, and we have decided that it would be best if both the State and local governments agreed to any enterprise zone proposal being submitted to HUD.

I would say that the primary reason for that is that the effort must be both on the State and local government to come forward with a program that they are willing to put into competition with the programs of other State and local governments that will be submitted to us. We think it would be very difficult for a local government to come forward with a program without getting any help whatsoever from a State. We think that the two go together, and that is what should be done. We do not have the apprehension that some of the mayors have about this.

Senator CHAFEE. Well, we have a Governor testifying here and also a Lieutenant Governor, so we will be asking them about their approach to that.

On page 4 of our statement and in several other places you refer to the regulatory relief that can be granted. Now, I must say I am a little confused as to what that regulatory relief is, because it can involve the discriminatory statutes—you made that very clear. It doesn't involve the minimum wage; it doesn't involve matters that affect health and safety; so, what's left?

The reason I press you on that is because the inclusion of the regulatory relief in this legislation causes jurisdictional problems within the Congress. For example, the regulatory relief provision would require it to go to the Judiciary Committee in the House of Representatives. And I'm just not sure what is gained from this regulatory relief if nothing can actually be done in connection with it.

On page 4 you say one of the elements is regulatory relief to reduce burdens which can be costly. Do you have an example of something that I can't think of that might provide regulatory relief that doesn't fall within the exclusions that you set forth?

Secretary PIERCE. Are you talking about at the Federal or at the State and local level?

Senator CHAFEE. Well, I'll take any of them. On the Federal, I certainly don't know what we could do.

Secretary PIERCE. Well, on the State and local you have a lot of them, and it would mostly fall there because you have the zoning, for example, which is very important, and there are many others that may be of significance on the local level—building code regulations, for example. There are quite a few rent control regulations, for example. There are many others, too. But there are quite a few of them. In fact, I have here a number listed which I would be glad to submit for the record on the local side. But there are a number; as I say, zoning and building regulations. They can be important. Rent control regulations can be important. All of these could be relaxed by the State and local governments, and it would be helpful to any business.

Senator CHAFEE. All right. I see the point you are making there. I do have a little problem as to whether——

Secretary PIERCE. And we do have a long list of Federal ones, too. I will just submit these for the record, if you would like, so you can have them.

Senator CHAFEE. All right.

Secretary PIERCE. There are many. I could just submit these for the record so you can consider them rather than just list them all here.

Senator CHAFEE. All right.

How do you envision the timetable of this working? When we say "25 per year," is that 25 per calendar year? And does that mean that the start of the year would be January 1983 and then running for the year? I am not quite sure of the mechanics.

Secretary PIERCE. Well, we would consider it a fiscal year, or it could be any year that the legislature sets as the year. It could be a calendar year or a fiscal year, but it's 1 year, 25 in that year, a 12-month period.

Senator CHAFEE. I see.

And has HUD got some of its ground rules set forth? For example, if you do 25 per year, and presumably we want to get started on this as soon as possible, is there a cutoff date and then the decision is made? Or do you select them as they come in—the best out of that group—and have some get started? Would that be your intention?

Secretary PIERCE. Our intention was to try to get started as soon as possible, but certainly you wouldn't take the first one that came in and just automatically allow that program to have the Federal relief. We would try to get a number in to compare them so that we could make some kind of intelligent selection. It's a comparative process.

Senator CHAFEE. What would you think if we put in a minimum? In some of the legislation that Senator Boschwitz and I submitted we had a minimum of not less than 10 nor more than 25. This legislation says "no more than 25." Are you confident that you can get these rolling rapidly?

Secretary PIERCE. I would think that there would be no trouble in getting 25 of them. I have traveled a lot about the country and talked to many mayors. They will be submitting, I think, literally hundreds of proposals to us very fast.

You know, actually, the Federal Government is a little bit behind on enterprise zones, because we already have eight States and the District of Columbia which have legislation on this, and there are 25 other States actively considering legislation. So they are moving quite fast, and they are going to move whether the Federal Government moves or not. And they are thinking about it, so I think there would be no trouble in getting 25 selected in a year.

I would like to say one other thing, though, sir. I think also we ought to give consideration to the nature of this program. It is experimental in a way, and I don't think we should just take the first 25 in and try to get rid of them just because we have a date to meet. I think we ought to see how they run a little bit. I think that's important, because we want to see how to do this. We have never done it before, and it is an experimental program.

Senator BOSCHWITZ. Would you yield for a moment?

I am pleased to hear the Secretary say that he intends to participate in the creation of 25; because, as you said, Senator, we had a 10 to 25 number before. I am pleased to see here that you will seek to do that.

Secretary PIERCE. It would depend on what came in and what we thought was right. As I said, it is also an experimental program; so I wouldn't just promise 25, come hell or high water. I don't think so.

Senator BOSCHWITZ. I was pleased to hear that you will seek to create 25 zones. I understand, of course, and I'm sure that we all understand, that the first 25 that come in are not prioritized on the date of application but rather of various needs.

It is an experimental program, as you point out. I would also hope that there will be some experimentation so that not all of them would be in inner cities but that smaller cities would be tried, perhaps a rural enterprise zone. The law as we wrote it is quite broad so that some experimentation could be tried, I believe, beyond just the most distressed areas of our inner cities. It is a program that I think can help beyond that, and I hope that HUD will look at the program beyond just the inner city aspects of it.

Secretary PIERCE. Well, we certainly intend to do that.

Senator BOSCHWITZ. Again, I am pleased to hear that you will seek to license or create as many as the law provides. And I understand it won't be done immediately.

Maybe I could rephrase Senator Chafee's question a little bit. I believe he asked if it is your intention to create them all at once. Have you thought at all about that? Or would you create as you received hundreds of applications? Not all of them would have to be created, I would presume, in one fell swoop, at a certain date, but it may be that the first three, four, five are created and then more thereafter.

Secretary PIERCE. I would think that what we would do, and I think this is a matter of regulatory process, to enforce the law—we would set down certain times of the year that selections would be made so you get a chance to get some in, and then you make a choice from a group, the same as we do with UDAG applications. You get so many in and you make a decision at a certain time, and then another within another several months, and so on. If we do it that way, then we can be sure that we have at least a sizable number of applications and that the choice will be relatively fair.

Senator CHAFEE. Do you have the manpower within your Department to handle this program?

Secretary PIERCE. Yes, I believe we have. And we have taken the lead on drafting it, working on it. Our people have become quite expert, I think, in this.

Senator CHAFEE. But I mean to sort through these applications? What is the office that will handle it?

Secretary PIERCE. Basically two offices: community policy and development, and policy development and research.

Senator CHAFEE. I see.

Do you have any more questions?

Senator BOSCHWITZ. Do you have any sense of how many applications you will receive?

Secretary **Pierce**. Only from what I hear from mayors I talk to. I would say that we would literally get hundreds within the first year.

Senator **Boschwitz**. I think that that's a very healthy sign with respect to this bill and its intent. And if we receive hundreds, I think that bodes well for the program.

Secretary **Pierce**. As I said, that's my information from mayors. All of them say they are going to send their programs. So if all of these fellows send their programs it will be quite a few.

Senator **Boschwitz**. Mr. Secretary, when mayors talk to me they certainly talk about it most optimistically. As a matter of fact, they are seeking from my end a great deal of help in doing this. And we will help them in the process of application. I hope this will not become more politicized than the normal Government programs. In any case, if there are hundreds of applications I think that it promises well for the program; because, if there is a realization among the mayors of this country that there are going to be hundreds of applications, in that case the applications are going to become stronger and stronger.

As they recognize that they have to make certain concessions, that they have to make certain tax incentives, that they have to provide certain forms of protection in the areas of safety and fire, and so forth, I think that we are going to see some very interesting enterprise zone applications that will act as, perhaps not magnets, but will act as very substantial incentives indeed.

The free trade zones of the world have created many jobs in many areas, and there is no reason why this can't succeed, particularly if, as you say, you have heard a great expression of interest. I have, too.

Senator **Chafee**. Well, thank you very much, Mr. Secretary, and we will be working more with you.

Let me ask you one final question. Have you been in contact with States at all? Are the States attempting to develop with you any kind of what we might call model legislation for their part of this, that you know of?

Secretary **Pierce**. Not to my knowledge. I have been in touch with States and with Governors. They are very interested in this legislation. A lot of them are interested in their individual States doing work in this area. For example, I have talked to Governor Thompson about a possible law in Illinois. So they are very interested, and I am sure that many States will pass laws on their own. As I said, we already have 8 plus the District of Columbia, and 25 we are pretty sure are going to pass within the next 6 months or so.

Senator **Chafee**. All right. Fine.

We appreciate your testifying, and obviously we will be working very closely in the days ahead.

Thank you.

Senator **Boschwitz**. Thank you.

Secretary **Pierce**. Thank you.

Senator **Chafee**. We are delighted that one of the coauthors of this legislation, Senator Boschwitz, is here.

Senator, if you would like to, we will hear your statement right now.

Senator Boschwitz has long been interested in this legislation. He is a coauthor of the bill that we have submitted.

So, if you would proceed, Senator.

STATEMENT OF RUDY BOSCHWITZ, U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator BOSCHWITZ. Thank you, Mr. Chairman.

Last July I testified before this committee on the second enterprise legislation that you and I introduced together. As I stated then, this bill is not viewed by the sponsors as an alternative to current urban or rural programs, but it does address the primary ingredient in the revitalization of distressed areas, and that is, creating jobs. This is not the answer to unemployment; this is not the answer to all the problems that we face; but it is a significant step forward, and it is going to be an area of help. We are not going to see unemployment go from 8 or 9 percent down to 5 or 6, but it will impact the most difficult parts of the unemployment picture, and that is the areas where there is 30 and 40 percent unemployment.

Since enterprise zone legislation was first introduced, we have sought the thoughts and suggestions of many, many people. Not everyone has agreed with each provision of the bill, but all have welcomed a fresh approach in helping to solve the problems of poverty and joblessness in America.

The bill in its present form is a good one, I believe, Mr. Chairman. It recognizes that to provide lasting and meaningful jobs that those living in distressed areas must look to the private sector. This legislation, then, must aid in overcoming existing hurdles to businesses wishing to locate in those distressed areas.

As one who started and operated my own business for a number of years before coming to the Senate, I have to ask myself, Would I open one of my businesses in an enterprise zone? Frankly, the answer would be no. I was a retailer, and it's hard to attract retail customers to what I perceive enterprise zones will be. However, I was also a wholesaler, and I had a wholesale warehouse where I employed 30 or 40 people. An enterprise zone indeed would be a very fitting place for such an operation.

So, I view this bill and the enterprise zones from a businessman's perspective. There are many tax incentives in the bill such as elimination of capital gains taxes for business investment, an increase in investment tax credits, and the 50-percent tax credit for wages paid to previously unemployed disadvantaged workers.

I heard the Secretary state that small businesses don't make large profits, but I find my experience shows that small businesses can be quite profitable, and they pay taxes. They are not quite as sophisticated in their means of overcoming the tax laws.

I heard the Secretary say that most of them like to make money in the first 20 years they exist. My God, most of them like to make it even in the first year or two. I certainly was in that category.

But there are more problems faced by small businesses wishing to locate in enterprise zones that can't be corrected by the Federal Government, such problems as crime, weak infrastructures support that are found in some cities remain as barriers to business development. If you can't get insurance in the South Bronx—fire insurance or theft insurance—you simply are not going to open a business there. So, those kinds of problems have to be solved, and I'm sure that they will be solved in the process of the application for enterprise zone designation.

We have tackled this problem by combining incentives provided by the Federal Government with those of local governments, and I am really very buoyed by the statements of the Secretary, who says that he feels there will be hundreds. He doesn't know for sure, but I agree with that figure, that there will be hundreds of applications for enterprise zones. I know the number that will be coming from my State where we have already passed an Enterprise Zone Act. We are one of the eight States that the Secretary talked about. And I know that we will bid very agressively in seeking an enterprise zone.

The idea of hundreds of communities bidding will make that bidding process very intense, and the advantages given to people who will locate in those zones meaningful. So, I think that it bodes well for the success of this legislation.

When we held hearings at the Small Business Committee, the chief concern of witnesses was the lack of incentives to provide startup capital for small enterprises. Granted, the capital gains exemption for investment is nice, but I don't think small businesses look to making capital gains; they look to make a profit but not a capital gain.

So I hope as you listen to testimony, Mr. Chairman, that you will consider the various ideas that will come up with respect to capital formation and capital creation and the possibility of some tax credits for people who invest in small businesses in enterprise zones. I know that your chairman of this committee is sometimes somewhat reluctant to give tax credits that would be tax expenditures, particularly in this day of budgetary stringency; but if we are to make the enterprise zone legislation work, it would no doubt work much better if there were some incentives for capital formation.

I am optimistic about the enterprise zone legislation. I am optimistic that we are on the right path with it and that it will work. Just as free trade zones, free ports have worked throughout the world, so I believe that enterprise zones will work. Not each one of the 25 will work with sparking success, but without question we are going to create some jobs, and we are going to contribute through this legislation to relieving some of the distress of the more unfortunate areas of our country.

Thank you, Mr. Chairman.

[The prepared statement follows:]

TESTIMONY OF SENATOR RUDY BOSCHWITZ
ON THE ENTERPRISE ZONE ACT OF 1982

APRIL 21, 1982
9:30 A.M.

LAST JULY I TESTIFIED BEFORE THIS COMMITTEE ON THE SECOND ENTERPRISE ZONE LEGISLATION SENATOR CHAFEE AND I INTRODUCED IN THE SENATE. AS I STATED THEN, THIS BILL IS NOT VIEWED BY ITS SPONSORS AS AN ALTERNATIVE TO CURRENT URBAN OR RURAL PROGRAMS. BUT IT DOES ADDRESS THE PRIMARY INGREDIENT IN THE RE-VITALIZATION OF DISTRESSED AREAS -- THAT IS, CREATING JOBS.

SINCE ENTERPRISE ZONE LEGISLATION WAS FIRST INTRODUCED, WE HAVE SOUGHT THE THOUGHTS AND SUGGESTIONS OF MANY, MANY PEOPLE. NOT EVERYONE HAS AGREED WITH EACH PROVISION OF THE BILL, BUT ALL HAVE WELCOMED A FRESH APPROACH TO HELPING SOLVE THE PROBLEMS OF POVERTY AND JOBLESSNESS IN AMERICA.

THE BILL IN ITS PRESENT FORM IS A GOOD ONE. IT RECOGNIZES THAT TO PROVIDE LASTING, MEANINGFUL JOBS TO THOSE LIVING IN DISTRESSED AREAS WE MUST LOOK TO BUSINESS -- PRIMARILY SMALL BUSINESS. THIS LEGISLATION, THEN, MUST AID IN OVERCOMING

EXISTING HURDLES TO BUSINESSES WISHING TO LOCATE IN THESES DISTRESSED AREAS.

AS ONE WHO STARTED AND OPERATED MY OWN BUSINESS BEFORE COMING TO THE SENATE, I TEND TO VIEW THIS BILL WITH THE THOUGHT IN MIND -- WOULD I OPEN A BUSINESS IN AN ENTERPRISE ZONE? FRANKLY, IN MY BUSINESS EXPERIENCE AS A RETAILER, I THINK MOST RETAILERS WOULD NOT BE ATTRACTED TO ENTERPRISE ZONES BECAUSE IT IS HARD TO ATTRACT CUSTOMERS TO A DEPRESSED AREA. BUT MY BUSINESS ALSO HAD A LARGE WHOLESALING FUNCTION, AND THAT WOULD BE A VERY APPROPRIATE BUSINESS FOR AN ENTERPRISE ZONE. IN OUR WHOLESALING OPERATION WE PROBABLY HAVE 40 OR 50 PEOPLE EMPLOYED, WHICH IS JUST THE KIND OF BUSINESS WE HOPE TO ATTRACT TO AN ENTERPRISE ZONE.

SO I VIEW THIS BILL, AND ENTERPRISE ZONES, FROM A BUSINESSMAN'S PERSPECTIVE. THERE ARE MANY TAX INCENTIVES IN THIS BILL, SUCH AS ELIMINATION OF CAPITAL GAINS TAXES FOR BUSINESS INVESTMENT, AN INCREASE IN INVESTMENT TAX CREDITS AND A FIFTY PERCENT TAX CREDIT FOR WAGES PAID TO PREVIOUSLY UNEMPLOYED DISADVANTAGED WORKERS.

BUT THERE ARE OTHER PROBLEMS FACED BY SMALL BUSINESSES WISHING TO LOCATE IN ENTERPRISE ZONES THAT CANNOT BE CORRECTED BY THE FEDERAL GOVERNMENT. SUCH PROBLEMS AS CRIME, WEAK INFRASTRUCTURES SUPPORT AND CITY TAXES REMAIN BARRIERS TO BUSINESS DEVELOPMENT. THESE SERVE AS A DOUBLE WHAMMY WHEN YOU CONSIDER THAT A PROSPECTIVE BUSINESS ALREADY FACES THE USUAL PROBLEMS OF TAX BURDENS, START-UP CAPITAL AND TECHNICAL EXPERTISE.

WE HAVE TACKLED THIS PROBLEM BY COMBINING INCENTIVES PROVIDED BY THE FEDERAL GOVERNMENT WITH THOSE OF LOCAL GOVERNMENTS. THAT AN AREA SHOWS SIGNS OF HIGH UNEMPLOYMENT, POVERTY, OR OUT-MIGRATION IS NOT ENOUGH TO QUALIFY FOR AN ENTERPRISE ZONE DESIGNATION. THE LOCAL GOVERNMENT MUST ALSO ASSEMBLE A PACKAGE OF TAX AND OTHER INCENTIVES THAT MEET THE PARTICULAR PROBLEMS OF THE AREA. MOREOVER, THE AWARD OF AN ENTERPRISE ZONE WILL BE GRANTED ON A COMPETITIVE BASIS TO TEST LOCAL COMMITMENT. THAT COULD INCLUDE ANY NUMBER OF THINGS, SUCH AS IMPROVED INFRASTRUCTURE SUPPORT, REDUCTION OF LOCAL TAXES, RELAXATION OF LOCAL REGULATIONS, MANAGERIAL ASSISTANCE AND TECHNICAL HELP.

WHILE THE TAX INCENTIVES AND LOCAL GOVERNMENT PARTICIPATION WILL GO FAR IN ENCOURAGING BUSINESSES INTO ENTERPRISE ZONES, I DO THINK THE LEGISLATION CAN BE FURTHER IMPROVED. IN FEBRUARY I CHAIRED A SMALL BUSINESS COMMITTEE HEARING ON THIS LEGISLATION AND HEARD FROM WITNESSES ADDRESSING THE ISSUE OF WHETHER THIS LEGISLATION WENT FAR ENOUGH TO ATTRACT BUSINESS.

THE CHIEF CONCERN OF THE WITNESSES WAS THE LACK OF INCENTIVE TO PROVIDE START-UP CAPITAL FOR SMALL ENTERPRISES. GRANTED, THE CAPITAL GAINS EXEMPTION FOR INVESTMENT AND THE INVESTMENT TAX CREDITS ADDRESS THE PROBLEM SOMEWHAT. BUT MANY, PERHAPS MOST SMALL BUSINESSES START UP BY LEASING EQUIPMENT AND OFFICE SPACE. THEY NEED MONEY TO COVER SUCH THINGS AS PAYROLL, INVENTORY, LIGHTS AND OFFICE SUPPLIES, AND AN INVESTMENT TAX CREDIT OR CAPITAL GAINS EXCLUSION ISN'T GOING TO HELP MUCH HERE.

WHIAT IS NEEDED, AS ONE OF OUR WITNESSES DR. DAVID BURCH, PUT

SO DESCRIPTIVELY IS SOMETHING THAT WILL HAVE AN IMPACT ON THE "AUNT AGATHA'S" OF THE COUNTRY. THAT IS, FAMILY MEMBERS OR FRIENDS WHO HAVE TRADITIONALLY PROVIDED MONEY FOR NEW SMALL BUSINESSES. THIS COURSE HAS OFTEN BEEN THE ONLY ONE AVAILABLE FOR UNTESTED BUSINESSES WITHOUT ESTABLISHED BANKING LINES OF CREDIT.

ALLOWING THESE INVESTORS TO DEDUCT FROM THEIR TAXES IN THE FIRST YEAR OR TWO ALL OR SUBSTANTIALLY ALL OF THE MONEY INVESTED IN SMALL BUSINESSES WOULD BE A SIGNIFICANT BOON FOR THESE NEW ENTERPRISE ZONE BUSINESSES. I BELIEVE THIS WOULD NOT ONLY IMPACT THE AUNT AGATHA'S, BUT ALSO PEOPLE WHO INVEST IN THE MANY TAX SHELTERED INVESTMENTS. BECAUSE MUCH OF THE MONEY WOULD HAVE BEEN INVESTED IN TAX SHELTERS IN ANY EVENT, I DON'T THINK THE REVENUE LOST BY THE TREASURY WOULD BE GREAT. GIVEN THAT SOME PEOPLE WILL ALWAYS BE LOOKING FOR TAX SHELTERS, WE OUGHT TO TAP THIS POOL OF POTENTIAL FUNDS FOR A WORTHWHILE PURPOSE -- THE CREATION OF NEW BUSINESSES AND, THEREFORE, NEW JOBS.

THERE ARE OTHER IDEAS, SUCH AS ALLOWING INDIVIDUALS TO PURCHASE STOCK IN AN ENTERPRISE ZONE FIRM, THE STOCK BEING A VARIATION OF SECTION 1244 STOCK, AND ALLOWING IMMEDIATE DEDUCTION OF THE COST OF THE STOCK. THIS IS AN IDEA DEVELOPED BY PAUL PRYDE, ONE OF YOUR WITNESSES THIS AFTERNOON. ANOTHER SUGGESTION WOULD BE TO ALLOW A TAX CREDIT, SAY 25% OF THE AMOUNT INVESTED, INSTEAD OF A DEDUCTION.

I ENCOURAGE THIS COMMITTEE TO SERIOUSLY CONSIDER INVESTMENT INCENTIVES SIMILAR TO THE ONES I HAVE MENTIONED. ENTERPRISE ZONE LEGISLATION AS CURRENTLY DRAFTED IS GOOD, AND CAN BE MADE BETTER. I LOOK FORWARD TO WORKING WITH THIS COMMITTEE IN THE DEVELOPMENT -- AND PASSAGE -- OF THIS MUCH NEEDED LEGISLATION.

Senator CHAFEE. Thank you for a very fine statement. I think the points you make are so good.

It seems to me that what we are trying to do under this is to provide jobs where the people are, and we are trying to use the infrastructure that has built up within a city instead of transporting the people out of the city to some rural area or some suburban area where a plant is located.

I am very optimistic about this legislation. I like the point you made about the competitiveness. With scores or hundreds—let's say it's hundreds, hopefully—proposals submitted it's obvious that the cities and towns are going to be competitive and they are going to try to come up with their very best.

The points you made are excellent. If you would like to join us here at the rostrum, Senator, we would be delighted to have you. I know your time is constricted, but any time you can give us we would appreciate.

Senator BOSCHWITZ. Thank you very much, Mr. Chairman.

Senator CHAFEE. All right, now, Secretary Chapoton, if you would come up and help us with some of the tax provisions of this legislation.

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. CHAPOTON. Thank you, Mr. Chairman.

I am pleased to have the opportunity to appear before the subcommittee today to present the Federal tax features of the administration's enterprise zone program.

As Secretary Pierce and the Senators have indicated, this program is an experimental initiative designed to relieve economic distress in inner cities and rural towns. The program is structured to create a free-market environment in depressed areas through the removal of Government burdens. This should create and expand economic opportunities within the zones leading to an expansion of economic activity and the creation of jobs within these areas.

While the Federal tax incentives are an important part of the program, unlike many of the past programs to deal with the economic problems of depressed areas, the success of the enterprise zone program will depend largely on contributions made by the State and local governments to improve services and through relief of local taxes, regulations, and other burdens that may inhibit economic activity in the designated areas.

Since the enterprise zone concept is designed to create a free-market environment for business, the intent is not to foster a particular kind of business activity. The Federal tax features of the program therefore contain strong incentives for labor-intensive businesses and the creation of jobs through employment credits, and also include a number of tax credits and other incentives for the formation of capital. On the whole, the effect of the Federal tax package will be to reduce significantly the tax payable by employers on ordinary income generated by activities in the designated zones, to eliminate entirely the capital gains tax on certain types of property used primarily within the zones, to retain the currently favorable rules for exempt small issue industrial development bonds financing zone activities, and to provide income tax relief for qualified employees of firms doing business within a designated zone.

I would like to outline the major features of the Federal tax incentives for businesses operating within the designated zone areas in more detail.

To begin with, there are two separate payroll credits for employers doing business in the zones. One is designed to encourage the creation of new employment generally, and the other is a targeted incentive to encourage the hiring and training of certain disadvantaged individuals.

The first credit is a nonrefundable 10-percent income tax credit to enterprise zone employers for payroll paid to qualified zone employees in excess of the payroll paid to such employees in the year prior to zone designation. The wages taken into account for purposes of this credit are limited to 2½ times the FUTA base—the Federal Unemployment Tax Act base. That wage base is currently $6,000 per employee. Thus, the current maximum credit will be 10 percent of each employee's wages up to $15,000, 2½ $6,000, or $1,500 per employee.

The 10-percent credit is designed to attract labor intensive business activities to the enterprise zone areas and encourage firms already operating within those areas to expand. With a cap of $15,000 on wages to which the credit applies, the incentive is focused on jobs for unskilled workers and those with some training but still in the lower middle-income brackets.

The second payroll credit is a special, nonrefundable income tax credit to employers for wages paid to zone employees who were disadvantaged when hired. This credit will be 50 percent of wages paid, without limit, without any cap at all, to each disadvantaged individual during each of the first 3 years he is employed, and the credit will decline by 10 percent per year thereafter, so it would phase out completely after the seventh year of employment.

The definition of "disadvantaged workers" which is focused on low-income and hard-to-employ individuals, was derived from the targeted jobs tax credit definition with certain modifications to bring it more in line with the CETA definition. The list of disadvantaged workers includes vocational rehabilitation referrals, SSI recipients, general assistance recipients, economically disadvantaged individuals——

Senator CHAFEE. That's a very complicated list, Mr. Chapoton. Why didn't you just use "CETA-eligible"?

Mr. CHAPOTON. Well, we had had some experience with the targeted jobs tax credit, and we keyed more to that and brought in the CETA-eligibles, but we wanted a broader list and to get more of the hard-to-employ.

Senator CHAFEE. All right.

Mr. CHAPOTON. It is a broader category. It is quite a broad category.

The first three categories were selected from the targeted jobs tax credit provisions; that is, vocational rehabilitation referrals, SSI recipients, and general assistance recipients. As I mentioned, the category of economically disadvantaged individuals is the broadest category and is defined to include an individual who is a member of a family whose income is no more than an eligible family would have received in food stamps plus AFDC benefits. This special credit for disadvantaged persons is the strongest tax incentive ever provided for the hiring of disadvantaged workers.

The 3-year duration and the phaseout will provide the employer with sufficient time to undertake a long-term training program addressed to the needs of these disadvantaged workers.

Senator **CHAFEE**. Of course, he has to be making money to have this be of any value. Tax cuts aren't any good unless you are making a profit.

Mr. **CHAPOTON**. Or an investor in a partnership offsets it against other income. It does not have to be zone income. So the zone operation itself could be not making a profit, but it could offset tax liability from outside of the zone.

Senator **CHAFEE**. Do you mean if General Electric has a plant in one of these areas they can take it against their overall profits?

Mr. **CHAPOTON**. That is correct.

Senator **CHAFEE**. Did you consider the refundable job tax credits?

Mr. **CHAPOTON**. We did not want the refundability feature.

Senator **CHAFEE**. That just opens too many doors?

Mr. **CHAPOTON**. That just opens too many doors. That is constant pressure on refundability, and we didn't want to get into it here.

Senator **CHAFEE**. All right.

Mr. **CHAPOTON**. In addition to the regular and special payroll credits, a zone employer's payroll cost will be reduced by an allowable employee credit. A zone employee will be entitled to a nonrefundable 5-percent income tax credit for wages earned in zone employment up to 1½ times the FUTA wage base—as I mentioned, that is currently $6,000, and thus the current maximum will be 5 percent of $9,000 or a $450 credit for each employee. This credit will increase take-home pay to qualified employees who work in the zone. Such a benefit should be an important factor in inducing workers to accept employment within the zones, which may initially be somewhat undesirable places to work.

As I mentioned earlier, the Federal tax incentives contain not only strong incentives for labor-intensive businesses but also provide stimulus for capital investment in the zones through special investment tax credits. On top of the regular investment tax credit allowable under the law, an additional nonrefundable investment tax credit is provided for capital investments in an enterprise zone. For personal property such as machinery or equipment, the additional credit will be 3 percent for property in the 3-year ACRS life and 5 percent for all other equipment, the 5- and 10-year ACRS property. In each case this represents a 50-percent increase in the investment tax credit allowable under normal law.

In addition, a new 10-percent credit will also be provided for the construction or rehabilitation of commercial, industrial, or rental housing structures within a zone. So you would have a credit for the first time for real property, real structures.

Capital gains will be accorded a favorable tax treatment in enterprise zones to stimulate investment in the zone by real estate developers and by entrepreneurs and venture capitalists seeking to start up and build new businesses in the zone. Specifically, with certain exceptions to prevent abuse, long-term capital gain from the sale of tangible property used in a zone business or from the sale of an interest in a zone business will be entirely exempt from capital gains tax. This provision should attract to the zones new small businesses with substantial growth potential and more generally should encourage capital improvements within the zone areas.

In addition to the investment tax credits and the special rules for zone capital gains, a preservation of the present rules for small issue industrial development bonds will help small businesses to obtain low-cost financing to begin or expand their ventures.

The administration is currently proposing that certain changes be made in the applicable rules to industrial development bonds, but with the exception of the proposed change in the arbitrage restriction and the proposed requirement for registration of all private-purpose tax exempt bonds, the new rules would not be applicable to small issue industrial development bonds financing zone activities, and the present rules would remain in effect with respect to small issue industrial development bonds for the entire period of the enterprise zone notwithstanding the proposals we are making and notwithstanding any subsequent amendments to the industrial development bond provisions.

The last major feature of the Federal tax incentive is an extension of the carryover period for operating losses and credits. As you know, Mr. Chairman, present law allows a firm sustaining net operating losses in 1 year to carry those losses forward to offset taxable income in future profitable years. And if a firm does not have sufficient tax liability to take advantage of all of its credits in 1 year, it may now carry forward excess credits to future years. Both of those credits may now be carried over for a 15-year period; under the enterprise zone program the credits and net operating losses would be allowed to be carried over for any period of time beyond the 15 years as long as the zone was still an enterprise zone. So it would be basically up to the full 20-year-plus phase-out of the enterprise zone designation.

Turning to our revenue estimates, as was mentioned earlier, because we are not certain of the number, size, and characteristics of the actual zones to be designated, the revenue estimates can be expected to change as the zones are actually designated by HUD. Also the revenue costs increase in future years as the number of zones and business activities within each zone increase.

We are presently projecting revenue losses starting out at $0.1 billion in 1983, $0.4 billion in 1984, and rising to $1.3 billion in 1987. These estimates, I should point out, are somewhat different than those shown in the President's budget message which predicted starting out at $0.1 billion in 1984 and rising to $0.5 billion in 1985. This is due to the fact that the legislation has been put forward somewhat earlier than expected, and it is now expected that zones could be designated in early 1983. Thus, our revenue estimates were increased to take that into account.

In concluding, Mr. Chairman, I would like to emphasize that the enterprise zone program is not just another attempt to solve a problem by throwing money at it; rather, it represents a fresh approach for dealing with the problems of economically distressed areas.

Unlike the programs put forth in the past, enterprise zones should spur economic activity by removing one of the largest barriers to its growth—excessive governmental regulation. We are confident that the total program contains the necessary ingredients to make it a success.

Thank you, Mr. Chairman.

[The prepared statement follows:]

For Release Upon Delivery
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April 21, 1982

STATEMENT OF
THE HONORABLE JOHN E. CHAPOTON
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE SENATE FINANCE COMMITTEE
SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to appear before you today to discuss the Federal tax features of the Administration's enterprise zone program.

The enterprise zone program is an experimental initiative designed to relieve economic distress in inner cities and rural towns. The program is structured to create a free-market environment in depressed areas through the removal of government burdens. This should create and expand economic opportunities within the zones leading to an expansion of economic activity and the creation of jobs within these areas. While the Federal tax incentives are an important part of the program, unlike many of the past programs to deal with the economic problems of depressed areas, the success of the enterprise zone program will depend largely on contributions made by the State and local governments through improved services and through relief of local taxes, regulations, and other burdens that may inhibit economic activity in these designated areas. In addition, the program is dependent upon the involvement of private organizations. Efforts will be made to experiment with private firms providing traditional city services, and more involvement by private-sector neighborhood organizations will be encouraged.

Since the enterprise zone concept is designed to create a free-market environment for business, the intent is not to foster a particular kind of business activity. The Federal tax features of the program therefore contain strong incentives for labor-intensive businesses and the creation of jobs through employment credits, and also include a number of tax credits and other incentives for the formation of capital. On the whole, the effect of the Federal tax package will be to reduce significantly the tax payable by employers on ordinary income generated by activities in designated zones, eliminate entirely the capital gains tax on certain types of property used primarily within the zones, retain the currently favorable rules for exempt small issue industrial development bonds issued with respect to zone activities, and provide income tax relief for qualified employees of firms doing business within a designated zone.

I would now like to outline the major features of the Federal income tax incentives for businesses operating within a designated zone area.

A. Credits for Employers.

There are two separate payroll credits for employers doing business in the zones. One is designed to encourage the creation of new employment generally, and the other is a targeted incentive to encourage the hiring and training of certain disadvantaged individuals.

These payroll credits will be nonrefundable and will be available only with respect to "qualified employees," those who perform 50 percent or more of their services within an enterprise zone and at least 90 percent of whose services are directly related to the zone business. The amount of these credits will reduce the employer's deduction for wages. No zone credit is allowed with respect to individuals to whom the credits relating to the current work incentive programs or the general targeted jobs tax credit are claimed. For zones lasting between 21 and 24 years, both credits will phase out during this period, declining by 25 percent per year.

1. Credit for increased enterprise zone employment.

The general payroll credit for enterprise zone employers will be equal to 10 percent of their "qualified increased employment expenditures." This is the amount by which the payroll for qualified employees in any taxable year exceeds the payroll for the base period, which is the 12-month period prior to zone designation. Qualified wages are limited to

2-1/2 times the FUTA wage base (currently $6,000) per employee. Thus, the current maximum credit for qualified increased employment expenditures will be 10 percent of each employee's wages up to $15,000, or $1,500 per employee.

The 10-percent credit is designed to attract labor-intensive business activities to the enterprise zone areas and encourage firms already operating within those areas to expand. With a cap of $15,000 on wages to which the credit applies, the incentive is focused on jobs for unskilled workers and those with some training but still in the lower middle income brackets.

The credit is available to all employers for the qualified workers they employ within the zones, regardless of how many workers they employ elsewhere or what business activities they engage in outside of the zones. The credit will apply to wages paid by existing firms to net, additional workers, representing an increase in the firm's work force, subject to the annual maximum wage cap per worker. The credit will also apply to increased wages paid to existing workers and wages paid to replacement workers, above the total sum of wages paid to the former workers, all subject to the maximum annual wage cap per worker. The credit does not apply, however, to the existing payroll of an existing business within a zone at the time it is so designated, nor does it apply to a worker hired by such a firm to replace a former, pre-zone worker making the same wage.

As an example of how the credit is to work, assume that in a 12-month period prior to zone designation an employer employs two persons, A and B, at an annual salary of $12,000 each in an area which is to be designated as an enterprise zone. Since the employer's $24,000 pre-zone payroll is within the $15,000 per employee limit, that amount represents the base period wages. If after zone designation the employer gives each employee a raise of $1,000 per year, the employer's qualified payroll is $26,000 and its qualified increased employment expenditures are $2,000, qualifying it for a credit of $200. If in the next year the employer gives A a $5,000 raise (to $18,000), B a $2,000 raise (to $15,000), and hires a new employee, C, at an annual salary of $9,000, the employer's qualified payroll would increase to $39,000 ($15,000 of the $18,000 paid to A, $15,000 paid to B, and the entire $9,000 paid to C). This exceeds the $24,000 base period wages by $15,000, and the employer qualifies for a credit of $1,500.

2. Credit for employment of disadvantaged individuals.

In addition to the general payroll credit, enterprise zone employers will also be eligible for a special credit for wages paid to qualified employees who are disadvantaged individuals. This credit will be 50 percent of wages paid (without limit) to each disadvantaged worker during each of the first 3 years of employment, declining by 10 percent per year thereafter. On the day such individuals are hired, the individual must have received (or applied in writing for) a certification from a designated State employment security agency that such individual falls within one of the qualified categories.

This special credit is the strongest tax incentive ever provided for the hiring of disadvantaged workers. The 3-year duration and the phaseout will provide the employer with sufficient time to undertake a long-term training program addressed to the needs of the most disadvantaged workers. The definition of disadvantaged workers for purposes of this credit is focused on low-income and hard-to-employ individuals. The categories of disadvantaged individuals are:

(1) Vocational rehabilitation referrals. These include individuals who are physically or mentally handicapped and who have completed a vocational rehabilitation program;

(2) Economically disadvantaged individuals. These are persons who are members of a family that had an annual income equal to or less than that which an eligible family with no income would receive in food stamps plus AFDC benefits;

(3) Foster children. Individuals in this category include persons receiving State or local benefits under a program to assist foster children;

(4) SSI recipients. These are recipients of supplemental security income benefits for the aged, blind, and disabled under Title XVI of the Social Security Tax Act;

(5) General assistance recipients. These are individuals who are, within 60 days prior to hiring, receiving assistance under a State or local program which provides general assistance based on need and consists of money payments;

(6) Handicapped individuals. These are persons who are disabled and living at home or who are institutionalized, or who are a client of a sheltered workshop, prison, hospital, or similar institution, or in community care;

(7) Eligible AFDC recipients. These would include individuals qualifying for financial assistance under Part A of Title IV of the Social Security Tax Act who have received such assistance during the 90-day period immediately preceeding the hiring date.

The credit will be available to all employers for the disadvantaged workers they employ within the zones, regardless of the number of workers or amount of business conducted elsewhere. Additionally, the credit will apply only to disadvantaged workers hired after designation of the zone in which they are employed. These workers do not have to represent net additional workers or an increase in their employer's work force. The credit will therefore not apply to the past payroll of an existing business in a zone, but will apply, for example, to the replacement with disadvantaged workers of workers lost through attrition. Since the credit is intended to encourage the training and permanent employment of these disadvantaged individuals, the credit, with certain exceptions, generally will be recaptured if an individual is dismissed or fired within a year after being hired.

B. Employee Credits.

In addition to the regular and special payroll credits, an enterprise zone employer's payroll costs will be reduced by the allowable employee credit. An employee working in an enterprise zone will be entitled to a nonrefundable credit equal to 5 percent of wages paid for services performed within the enterprise zone, up to 1-1/2 times the FUTA wage base (currently $6,000). Thus, the current maximum credit will be 5 percent of $9,000, or $450. This credit will not be included in taxable income.

The tax credit will increase take-home pay to qualified employees who work in the zone. Such a benefit will be important to inducing workers to accept employment within the zones which may initially be somewhat undesirable places to work. For zones lasting between 21 and 24 years, the credit will phaseout during this period, declining by 25 percent per year.

C. Investment Tax Credit for Enterprise Zone Property.

As I mentioned earlier, the Federal tax incentives contain not only strong incentives for labor-intensive businesses, but also provide stimulus for capital investment in the zones through special investment tax credits and a capital gains exclusion.

With respect to tangible depreciable property used in the active conduct of a trade or business in an enterprise zone, a nonrefundable investment tax credit will be provided in addition to the regular investment tax credit. An additional 3-percent credit will be provided for property currently within the 3-year ACRS property class and an additional 5-percent credit will be available for all other depreciable tangible personal property. The 3- and 5-percent credits basically increase the regular investment tax credit by 50 percent. To be eligible for the credit, the personal property must be used predominately within the enterprise zone in a trade or business conducted in the zone. This will prevent the taking of the credit for highly mobile capital with only superficial connections to the zone.

With respect to real property, to encourage the development of commercial and industrial structures in zone areas, a 10-percent credit is provided for new construction and reconstruction of buildings in an enterprise zone after designation. The basis in real property will be reduced by the amount of the credit claimed.

The credits will apply only to capital investment made in a zone after it is so designated. Existing businesses in the zones will not receive any tax benefit for their past investment. These businesses will, however, be able to take the credit for all new investments whether to replace worn out capital currently in use or to increase capacity. Property which is sold or removed from an enterprise zone will be subject to a partial recapture of the credit equal to the percentage derived by dividing the number of years the property was used by the taxpayer by the life of the asset for earnings and profits purposes.

D. Capital Gains Exclusion.

The favorable tax treatment accorded capital gains within enterprise zones should stimulate investment in the zones by real estate developers and by entrepreneurs and venture capitalists seeking to start and build up new businesses. This should attract to the zones new, small businesses with substantial growth potential. More generally, the incentive will encourage capital investments within the zone areas.

Specifically, qualified enterprise zone capital gains will not be subject to tax. A qualified enterprise zone capital gain is defined as a long term capital gain from the sale of qualified property. Qualified property is tangible personal property and real property used by the taxpayer predominately in the active conduct of a trade or business in an enterprise zone, or it may be an interest in a corporation, partnership, or other entity, if for the 3 most recent taxable years of the entity ending before the date of disposition, the entity conducted a qualified business. A qualified business is an active trade or business conducted within an enterprise zone, with respect to which at least 80 percent of the gross receipts were attributable to such active conduct of a trade or business, and substantially all the tangible assets of which are located within an enterprise zone.

Special rules are provided which are designed to curtail the potential for abuse in this area. For example, gain from the sale of an interest in a qualified business will not qualify for exclusion to the extent it is attributable to: (1) any property contributed to the business within the previous 12 months, (2) any interest owned by a qualified business in any other business which is not a qualified business, and (3) any other intangible property owned by the qualified business which was not created as part of a active trade or business within an enterprise zone after designation of the area as an enterprise zone.

These special capital gains provisions will continue to apply after zone designation lapses until the first time each item of otherwise qualified property was sold or exchanged. This would assure investors that they will be able to receive the benefit of this incentive and avoid a rush to sell zone property when the end of the zone period approaches.

E. Small Issue Industrial Development Bonds.

In addition to the additional investment tax credits and special rule for zone capital gain, preservation of the present rules for small issue industrial development bonds will help small businesses to obtain low-cost financing to begin or expand their ventures.

The Administration is currently proposing that certain changes be made in the rules applicable to obligations, the interest on which is exempt from Federal income tax.

However, except for certain proposed amendments to arbitrage restrictions and the registration of tax-exempt bonds, the present rules for small issue IDB's will remain in effect during the entire period for which an area is designated as an enterprise zone notwithstanding any subsequent amendments to those provisions.

F. Extension of Carryover Periods.

The last major feature of the Federal tax incentives is an extension of the carryover period for operating losses and credits.

Present law allows a firm sustaining losses in one year to deduct those losses in future, profitable years. Similarly, if a firm has insufficient tax liability to take advantage of all of its credits in one year, it may take those credits against income tax liability in future years. The carryover period for operating losses and credits is 15 years.

Under the enterprise zone program, any net operating loss generated from the active conduct of a trade or business within an enterprise zone and any credits for enterprise zone employment or for investment in property used in an enterprise zone business, may be carried over for the longer of 15 years or the period of time for which a designation as an enterprise zone is in effect.

New businesses generally suffer losses in their initial years, and it may be several more years before they have sufficient pre-tax income against which to deduct these losses or tax liability to be offset by their available tax credits. Extending the carryover period and allowing the zone credits to be carried over will, therefore, reduce the risk of starting a new business. This is particularly true for small businesses which may not have nonzone income against which to deduct their losses, as larger firms usually have.

G. Revenue Estimates.

Because we are not certain of the number, size, and characteristics of the actual zones to be designated, the revenue estimates were based on a representative zone containing 10,000 employees. The estimates therefore can be expected to change as the zones are actually designated by HUD. Also, the revenue costs increase in future years as the number of zones and business activity within each zone increase. The projected revenue losses for the first several year are:

Fiscal Years

($ billions)

1982	1983	1984	1985	1986	1987
--	0.1	0.4	0.8	1.0	1.3

You will note that these revenue estimates differ from those shown in the President's Budget Message which projects losses of $0.1 billion in 1984 and $0.5 billion in 1985. This is because at the time the Budget was being prepared for printing, the draft bill was incomplete and the timing of its introduction uncertain. Assuming Congress passes enterprise zone legislation this year, we now expect that the first zones could be designated in early 1983, and our revenue estimates were revised to take this into account.

Conclusion

The enterprise zone program is not just another attempt to solve a problem by throwing money at it. Rather, it represents a fresh approach for dealing with the problems of economically distressed areas. Unlike the programs put forth in the past, enterprise zones will spur economic activity by removing one of the largest barriers to its growth -- excessive governmental regulation. We are confident that the total program contains all the necessary ingredients to make it a complete success and I urge you to lend your support to our efforts.

Senator CHAFEE. Thank you, Mr. Chapoton.

I must say the employee credit was something we never thought of when we did our legislation, and I think it's an interesting approach. I think there is a problem in getting people to go to work in these areas, and if somebody can get an extra $450 maximum out of it, there is something to that. I suppose that could be subject to change as we consider this legislation.

What do you think about the complexity of this in the enforcement? Are these seven special tax provisions targeted to the employees, employers, and investors? How do you see the problems there from your point of view, from the Department's point of view?

Mr. CHAPOTON. Well, the complexity of it is one thing that was discussed in the development of the proposal. It is indeed mentioned in the legislation that the tax regulations and other regulations ought to avoid complexity whenever possible.

I think when you deal with credits you tend to avoid complexity more than other provisions of the tax law; and when we have just a straight exemption from capital gain, that's not very complex. So while any changes in the tax law are unfortunately somewhat complex, I think these are probably as simple tax provisions as you can provide.

Senator CHAFEE. Do you think there are possibilities of unwanted tax shelters emerging out of this?

Mr. CHAPOTON. Mr. Chairman, an unwanted tax shelter is pretty much in the eyes of the beholder. [Laughter.]

Clearly, there will be the ability to shelter nonzone income with these zone tax benefits; and that indeed is designed. As you point out, in many cases these operations, particularly in the early years, will not have tax liability, and thus in the Tax Code there is little that can be done for them.

Senator **Chafee**. Well, I suppose some of the investors will be sheltering income. That's the way we get them to put their money into the place.

Mr. **Chapoton**. That's what will attract them to put their money into the zone.

Senator **Chafee**. Well, thank you, Mr. Chapoton.

Senator Bradley?

Senator **Bradley**. Thank you, Mr. Chairman. Just one.

Are you in favor of the provision that would allow an individual or a corporation who invests in an urban enterprise zone to deduct up to $500,000 of that investment in stock?

Mr. **Chapoton**. No, sir. We are not.

Senator **Bradley**. Why?

Mr. **Chapoton**. Well, an expensing provision going in is, just in a word, too much, I think. These type provisions give lesser benefits immediately, but do provide a complete exemption for gain on the sale of the interest in the zone business. And by absolute expensing, I think it is simply too much at the front end.

Senator **Bradley**. Thank you.

Senator **Chafee**. All right.

Thank you again, Mr. Chapoton, and we will be working with you, obviously, in the days ahead.

Mr. Brady, Assistant Secretary of Commerce.

Mr. Brady, would you proceed?

STATEMENT OF HON. LAWRENCE BRADY, ASSISTANT SECRETARY OF COMMERCE FOR TRADE ADMINISTRATION

Mr. **Brady**. Mr. Chairman, Senator Bradley, I appreciate the opportunity to comment on foreign trade zones as a feature of the enterprise-zone concept.

Commerce Secretary Baldrige, who chairs the Foreign Trade Zones Board, has designated me as his alternate on the Board. This has given me an opportunity to become closely involved in its expending program which in recent years has seen foreign trade zones become widely available in ports of entry throughout the United States.

Currently we have 73 foreign trade zones authorized by the Board. This administration has approved 12 zones and views them as offering services that help them improve the climate for international trade-related business and investment, complementing the broader incentive programs for private enterprise used by States and communities in their economic development efforts.

Since the enterprise-zone concept is also based on incentives for economic development, there is a logical and functional relationship between enterprise zones and the foreign trade zone program. The ultimate objective is the same—helping sustain and create employment opportunities. The relationship could, in fact, be symbiotic, such as where an enterprise zone offers the necessary infrastructure, services, and cost-effective setting for reexport manufacturing operations.

I will briefly describe the FTZ program and how it works. Here with me today is John Da Ponte, who serves as the Board's executive secretary and director of the Commerce Department's FTZ staff. We are prepared to supplement my remarks with any details you might desire.

I want to begin by saying that the Commerce Department supports the inclusion of foreign trade zones as a feature of the administration's enterprise zone proposal. We are prepared to carry out the role assigned to Commerce in section 401(a) of S. 2298, which envisions the submission of applications to the FTZ Board in cases where foreign trade zones can serve a useful purpose, particularly for export operations. Applications in these cases would be given priority and expeditious treatment by the Board.

The foreign trade zone concept is as old as trade itself. It became part of our Customs system in 1934 when Congress passed the Foreign Trade Zones Act. An amendment in 1950 permitted manufacturing in zones, increasing their potential for contributing to the national economy. Until the past decade, however, there were less than 10 zones mainly devoted to seaport terminal operations. As costs of production in the United States have become more comparable to those of other industrialized nations, and with the effects of containerized cargo on shipments to inland ports, foreign trade zones have become more versatile and widely available.

The purpose of the FTZ Act is to provide flexibility in the Customs system, without sacrificing control, in order to assist firms exporting from the United States and to encourage further processing of goods here that might otherwise have been imported as finished products.

The concept involves the designation of areas in or adjacent to ports of entry as being outside Customs territory for the purpose of Customs entry procedures. Foreign goods moved into a zone are accounted for in inventory control systems approved and supervised by the U.S. Customs Service; but, while within the zone, they are exempt from Customs duties, quotas, and Federal excise taxes.

The goods can be stored, exhibited, inspected, processed, and used in manufacture. If reexported outside of the United States, any of these Customs duties or restrictions are forgiven. If the foreign goods enter the domestic market in their original or in an altered condition, a formal Customs entry must then be made. Duties are paid and restrictions applied either on the original items or on the emerging product, the choice being that of the importer.

The savings offered by zones include:

Full exemptions for reexports from Customs duties and restrictions.

Deferral of duties on imports, providing a cash-flow benefit particularly important at times of high interest rates.

Reduction of duties on imports either through the removal of scrap, waste, and substandard items or through the option of paying at the tariff rate on the finished product when it is a lower rate.

Holding goods until quota or other restrictions are satisfied.

As I noted earlier, these savings are designed to help companies compete in the evermore highly competitive world market from

U.S. locations, with a goal of keeping within the United States employment opportunities which would otherwise go overseas.

Applications for foreign trade zones are submitted by public or public-type corporations authorized to apply under the laws of the State in which the zone is to be located. The decisionmaking process involves an open-record proceeding, with hearings when appropriate. It usually takes 6 months to process a noncontroversial proposal. This processing time would usually be reduced in cases involving enterprise zones because of the priority requirement.

In reviewing applications for the establishment of foreign trade zones the FTZ Board looks for, first, a showing of need for the zone within the community, taking projected activity into account; and, second, a plan that includes a suitable site and method for financing and operating the project.

Essentially the same criteria would apply for zones within enterprise zones, though we would consider any special factors warranted under the circumstances. The first few cases should provide practical experience that could lead to adoption of special provisions in the FTZ Board's regulations. Approvals result in the issuance of grants of authority authorizing the establishment of the proposed zone. Projects are expected to change with time, and there are simple procedures for making changes in zone plans and sites.

Underlying the foreign trade zone concept is the expectation that its benefits will help generate activity that serves the public interest. For example, in 1980 the foreign trade zones served approximately 1,400 companies, handled $5 billion in merchandise, and provided 10,000 jobs. In 1981 we estimate it will provide 14,000 jobs.

In closing, and before taking any questions you might have, I would like to reiterate that it is in exporting and reexporting situations that foreign trade zones can make their greatest contribution to the enterprise zone. The enterprise-zone package of incentives could very well help attract to our shores many international trade related operations now conducted offshore for cost reasons. The Customs-free zone feature that the foreign trade zone would lend to the enterprise zone could be very important in these cases.

The Commerce Department and the FTZ staff is prepared to do its share to help make the enterprise zones successful in contributing to our national economy.

Senator CHAFEE. Thank you very much, Mr. Secretary, we appreciate that. I have an idea that foreign trade zones are generally located close to a port. Is that a misconception? Could you have a foreign trade zone in Kansas City?

Mr. BRADY. They are located next to ports, Mr. Chairman; but, of course, we are not only talking about seaports. There are airports, also.

Senator CHAFEE. Airports?

Mr. BRADY. That's right.

Senator CHAFEE. Is it your experience that they produce economic development close thereto? In other words, it isn't necessarily that having a foreign trade zone within an urban enterprise job zone would create more jobs—well, I suppose it would. That's your theory, isn't it?

Mr. **Brady**. I think, Mr. Chairman, it could very well. We have some experience, and obviously it varies, on the free trade zone: on the management of the zone, on its location, on the aggressiveness of the community involved. But certainly when you take a look at some of the zones that we have, for instance, the Volkswagen plant in Pennsylvania, the Nissan plant in Tennessee, as to a plant in Florida, there is no question but that jobs have been created, that they are import-substitution as well as export-creating, and that we have as a result of those zones retained jobs in the United States that probably would have flowed overseas. And that's one of the major objectives of the free trade zones.

Senator **Chafee**. And you think there is a compatability between these two zones?

Mr. **Brady**. I think, absolutely. I think, Mr. Chairman, as we look at the rest of this century and what the United States has to do to go through the reindustrialization process that we all recognize we must do, as we look at what we must do to become competitive, we look at the international marketplace as one which the United States has not really become engaged in to any significant extent.

Now, the share of our GNP related to export has increased in recent years, but not nearly as much as it has to if we are going to be able to increase competitively overseas and develop those additional jobs in the United States.

The world market is the market for the United States, and it is something that we must acknowledge much more so than we ever had.

Senator **Chafee**. Senator Bradley?

Senator **Bradley**. No questions, Mr. Chairman. Thank you.

Senator **Chafee**. Thank you very much, Mr. Secretary.

Again, we will be working with you and Mr. DaPonte as we proceed through this budget period.

Mr. **Brady**. Thank you, Mr. Chairman.

[The prepared statement of Lawrence J. Brady follows:]

STATEMENT OF LAWRENCE J. BRADY
ASSISTANT SECRETARY FOR TRADE ADMINISTRATION
U.S. DEPARTMENT OF COMMERCE
BEFORE
THE SENATE FINANCE COMMITTEE'S
SUBCOMMITTEE ON PENSIONS, SAVINGS AND INVESTMENT
APRIL 21, 1982

I appreciate this opportunity to comment on foreign-trade zones as a feature of the Enterprise Zone concept. Commerce Secretary Baldrige, who chairs the Foreign-Trade Zones Board, has designated me as his Alternate on the Board. This has given me an opportunity to become closely involved in this expanding program which in recent years has seen foreign-trade zones become widely available in ports of entry throughout the U.S. Currently we have seventy-three foreign-trade zones authorized by the Board. This Administration has approved twelve zones and views these as offering services that help improve the climate for international trade-related business and investment, complementing the broader incentive programs for private enterprise used by states and communities in their economic development efforts.

Since the Enterprise Zone concept is also based on incentives for economic development, there is a logical and functional relationship between Enterprise Zones and the foreign-trade zone program. The ultimate objective is the same -- helping sustain and create employment opportunities. The relationship could, in fact, be symbiotic, such as where an Enterprise Zone offers the necessary infrastructure, services, and cost-effective setting for reexport manufacturing operations.

I will briefly describe the FTZ program and how it works. Here with me today is John Da Ponte, who serves as the Board's executive secretary and director of the Commerce Department's FTZ Staff. We are prepared to supplement my remarks with any details you might desire.

I want to begin by saying that the Commerce Department supports the inclusion of foreign-trade zones as a feature of the Administration's Enterprise Zone proposal. We are prepared to carry-out the role assigned to Commerce in Section 401(a) of S.2298, which envisions the submission of applications to the FTZ Board in cases where foreign-trade zones can serve a useful purpose, particularly for export operations. Applications in these cases would be given priority and expeditious treatment by the Board.

The foreign-trade zone concept is as old as trade itself. It became part of our Customs system in 1934, when Congress passed the Foreign-Trade Zones Act. An amendment in 1950 permitted manufacture in zones, increasing their potential for contributing to the national economy. Until the past decade, however, there were less than 10 zone projects, mainly devoted to seaport terminal operations. As costs of production in the U.S. have become more comparable to those of other industrial nations, and with the effects of containerized cargo on shipments to inland ports, foreign-trade zones have become more versatile and widely available.

The purpose of the FTZ Act is to provide flexibility in the Customs system, without sacrificing control, in order to assist firms exporting from the U.S. and to encourage further processing of goods here that might otherwise have been imported as finished products.

The concept involves the designation of areas in or adjacent to ports of entry as being outside Customs territory for the purpose of Customs entry procedures. Foreign goods moved into a zone are accounted for in inventory control systems approved and supervised by the U.S. Customs Service; but, while within the Zone they are exempt from Customs duties, quotas, and federal excise taxes. The goods can be stored, exhibited, inspected, processed and used in manufacture. If reexported outside of the U.S., any of these Customs duties or restrictions are forgiven. If the foreign goods enter the domestic market in their original or an altered condition, a formal Customs entry must then be made. Duties are paid and restrictions applied either on the original items or on the emerging product, the choice being that of the importer. The savings offered by zones include:

- full exemptions for reexports from Customs duties and restrictions
- deferral of duties on imports, providing a cash-flow benefit particularly important at times of high interest rates
- reduction of duties on imports either through the removal of scrap, waste and substandard items, or through the option of paying at the tariff rate on the finished product when it is a lower rate
- holding goods until quota or other restrictions are satisfied

As I noted earlier, these savings are designed to help companies compete in the ever more highly competitive world market from U.S. locations, with a goal of keeping within the U.S. employment opportunities which would otherwise go overseas.

Applications for foreign-trade zones are submitted by public or public-type corporations authorized to apply under the laws of the State in which the zone is to be located. The decision-making process involves an open-record proceeding with hearings when appropriate. It usually takes six months to process a non-controversial proposal. This processing time would usually be reduced in cases involving Enterprise Zones because of the priority requirement.

In reviewing applications for the establishment of foreign-trade zones, the FTZ Board looks for (1) a showing of need for the zone within the community, taking projected activity into account, and (2) a plan that includes a suitable site and method for financing and operating the project.

Essentially the same criteria would apply for zones within Enterprise Zones, though we would consider any special factors warranted under the circumstances. The first few cases should provide practical experience that could lead to adoption of special provisions in the FTZ Board's regulations. Approvals result in the issuance of grants of authority (licenses) authorizing the establishment of the proposed zone. Projects are expected to change with time and there are simple procedures for making changes in zone plans and sites.

Underlying the foreign-trade zone concept is the expectation that its benefits will help generate activity that serves the public interest. For example, in 1980 Foreign-Trade Zones served approximately 1400 companies, handled $5 billion in merchandise and provided 10,000 jobs. In 1981 preliminary figures indicated 14,000 jobs were provided.

In closing, and before taking any questions you might have, I would like to reiterate that it is in exporting and reexporting situations that foreign-trade zones can make their greatest contribution to the Enterprise Zone. The Enterprise Zone package of incentives could very well help attract to our shores many international trade-related operations now conducted offshore for cost reasons. The Customs free zone feature that the foreign-trade zone would lend to the Enterprise Zone could be very important in these cases.

The Commerce Department and its FTZ Staff is prepared to do its share to help make Enterprise Zones successful in contributing to our national economy.

Senator CHAFEE. Is Governor Brown here?

All right, Governor, go to it. We will put your statement into the record, so you can summarize, if you wish. We welcome you here.

STATEMENT OF HON. JOHN Y. BROWN, GOVERNOR, STATE OF KENTUCKY

Governor BROWN. Thank you, Mr. Chairman.

I appreciate the invitation to address the subject of enterprise zones. I know from my own State, our No. 1 concern is unemployment. We have the highest level of unemployment in the State of Kentucky since the Depression, and I guess we can go back to the old parable that if you give a man a fish, you feed him for a day; if you teach him how to fish, you feed him for a lifetime. I think that is what enterprise zones will do for those areas that are unable to find any other solution to the problem of creating employment.

Senator CHAFEE. Your distinguished Senator is here, one of your distinguished Senators.

Governor BROWN. Hello, Senator Huddleston.

Senator CHAFEE. You may want to welcome the Governor. We have welcomed him.

Senator HUDDLESTON. Mr. Chairman, I am surprised that you are running as close to time as you are; so I'm running behind time, as usual.

First, I would commend the chairman and the committee for conducting this hearing, and I do want to introduce to the committee our distinguished Governor. I think it is particularly appropriate that he is a witness for this session. As you know, he is a man of great accomplishment in the business world. He took some of those same attributes of initiative, courage, determination, ability——

Governor BROWN. Keep going. [Laughter.]

Senator **Chafee**. He's trustworthy, loyal, helpful, friendly, courteous, kind. [Laughter.]

Senator **Huddleston**. Right on in to public service. He moved into the governorship of Kentucky at a particularly difficult time, as you know, of budget cutback and restraint, and he has done a truly amazing job for our State. I know that his comments on this subject will be very interesting to the committee and very helpful in plotting your future course.

Senator **Chafee**. Well, thank you, Senator Huddleston, for joining us. Obviously, we welcome you to stay as long as your schedule permits.

Governor, won't you proceed?

Governor **Brown**. Thank you, Mr. Chairman.

And thank you for that very nice introduction, Senator Huddleston.

I was alluding to a perfect example where enterprise zones will be so productive, in my judgment, and that's in the city of Louisville. Over the past year, in just the west end of Louisville, which would be an ideal area for an enterprise zone, unemployment exceeds 25 percent. Two-thirds of this area is black; and if you count youth employment, unemployment is over 50 percent.

Louisville is a city whose total population declined 16.5 in the 1970's. Over the past year we have examined the problems of the West End to try to develop a format and a plan of how to create jobs. We have identified potential business locations; we have identified the labor market; we have established vocational training schools; we have purchased an industrial development area in order to attract business; but without some kind of additional incentive I think we are very limited as far as bringing the jobs to the people.

We find that our black community cannot compete with other business throughout the community of Louisville and Jefferson County, and so, therefore, the only way to really put these people to work is to bring the employment to them, train them in order to participate and be qualified to work for the industries.

So, we have the groundwork laid.

Another area that we feel in Kentucky would be ideal and necessary to create an enterprise zone is in our mountains. Because this is a one-industry area of Kentucky, people are locked in by the very mountains that are going to look to the energy needs of this Nation. Some 90 percent of all the energy in reserve in America is in the form of coal but in the past coal has been subject to a boom and bust cycle. We see the need to diversify the economy. It is vitally important that we find an alternative type of employment for our people in the mountains. These are industrious, hard-working people, and we have the training system set up through our vocational training to train people for industry.

But this is a noncompetitive area, because the cost of transportation exceeds that of urban areas. And there are other factors. Living conditions are not compared to urban areas. So, therefore, we need to create the type of incentives necessary to bring business in where they can be competitive. We have the work force, but we need substantial incentives.

Now, Kentucky was the sixth State in the Nation to adopt legislation to implement enterprise zones. We had a 25-member commission that was bipartisan—Republicans, Democrats, labor, business—and they came up with the recommendation. It passed our legislature some 90 to 2, and our senate some 30 to 2. So it was an overwhelmingly accepted program, accepted by both bodies.

Our program is very similar to the Federal program. Our incentives at the State level—I would like to go over them briefly with you:

We removed the sales tax on building materials and on new and used equipment and machinery used in a zone.

The elimination of the capital gains tax on property in a zone.

Removal of the tax on interest income on loans made to a zone.

Removal of the motor vehicle usage tax on vehicles purchased and used by qualified businesses within a zone.

Extending the loss-carryforward period, which is 7 years under Kentucky law, to 20 years or the life of the zone.

Authority for local governments to give relief on property taxes as long as it doesn't affect the percentage that goes to education.

We did pretty much the same thing on regulations to provide regulatory relief. State agencies which promulgate administrative regulations may exempt zones from the effect of those regulations as long as it does not affect the public health and safety.

We think it is one of the best packages in the United States. The States are limited as far as the tax breaks they can give, and that's why it is so necessary that States' programs be complemented by the Federal program. That will give the significant tax credits and tax breaks necessary to really get this program moving.

What I like about the program—and I am a free enterprise person, I believe, the market ought to dictate the jobs and the development in this country—if successful it won't cost the Federal Government or the local government any money. There is little direct investment of tax dollars. Here, you are making productive areas of localities that are at this point nonproductive, that are on Federal welfare programs.

We are very excited about it in Kentucky. Our entire thrust has been on economic development. That not only the theme of our administration but also has been the thrust of all of our energies.

We have taken advantage, I think, of about all the financing vehicles that the law allows. Whether it is commercial bonding or industrial revenue bonding. We have what we call the Kentucky Industrial Finance Authority to help small business. The legislature just authorized the use of some $50 million to be used to help finance small business development. We have what we call economic development bonds, 100 million dollars' worth.

Part of these bonds were used last year, some $4 million, to open a steel company that had closed. Interlake Steel, that had closed in northern Kentucky, was reopened with 4 million dollars' worth of these bonds. That was secured by the land, the building, and the equipment. With that they got a HUD grant—a UDAG grant, I believe—of some $8 million, and then went to the financial market and borrowed $30 million. This put 600 people back to work. They made $2 million the first quarter and decided not to use the bonds.

So we have been very careful and selective in the manner in which we use these financial vehicles.

If you can give us a Federal program to go with our State program and our State financing vehicles, we are satisfied that we can create significant jobs and significant productivity in our State.

While we have tremendous investment and movement and expansion in commerce in Kentucky, this does not help solve the immediate problem of unemployment. As chairman of the National Governor's Association Small Business Task Force, I feel like the one area that has been neglected or ignored by the thrust of the administration is to create jobs through small business. Last year 86 percent of all new jobs in this Nation came from small business. Over 80 percent of new jobs created in the 1970's came from small business.

In the 1970's big industry, with sales of $200 million or more, actually lost jobs during this period of time. And if you break down the various tax incentives that you have, it is our best estimate that approximately 80 percent of the tax incentives go for the major corporations of sales of $200 million or more. So we are not really directing the incentives to segments that are going to create the jobs and the productivity to get this country moving.

I will be glad to elaborate on that—that's a side issue—but I feel very strongly that that is the area where the incentives and direction of development efforts should go, and this fits right in with really giving small business a chance to create jobs and create expansion and create a vibrant economy.

Thank you very much.

Senator **CHAFEE**. Well, thank you, Governor.

Does the National Governors' Association have model legislation on this? You and, I guess, Connecticut have passed some. Is there a similarity between it, or does each one more or less go off on his own?

Governor **BROWN**. I think they are pretty similar, as I understand it, except that the Connecticut legislation creates a task force to study areas for possible regulatory relief.

Senator **CHAFEE**. Basically sales taxes and the points you made in your presentation?

Governor **BROWN**. Yes.

Mr. **LUNSFORD**. I think ours is a little more extensive; is that correct?

Governor **BROWN**. I'm sorry. This is Bruce Lunsford, our secretary of commerce from Kentucky. He will also be available to answer any questions.

Senator **CHAFEE**. We welcome you here.

We would be interested to have a copy of your bill, if we could. If you don't have one with you and could mail us one, we would appreciate it. Just mail it to the committee here.

You've got one? There's a man that is prepared.

[A copy of the Kentucky bill follows:]

KENTUCKY'S ENTERPRISE ZONE LEGISLATION

SEVEN STATES HAVE ADOPTED MEASURES WHICH CAN BE DESCRIBED AS ENTERPRISE ZONES LEGISLATION (FLORIDA, CONNECTICUT, MARYLAND, LOUISIANA, OHIO, KENTUCKY AND MINNESOTA)

KENTUCKY WAS THE SIXTH STATE TO ADOPT ENTERPRISE ZONE LEGISLATION, HOWEVER; WE FEEL THAT KENTUCKY IS THE FOREFRONT IN ADOPTING ENTERPRISE ZONE LEGISLATION WHICH BEST COMPLIMENTS THE FEDERAL PROPOSALS ON ENTERPRISE ZONES.

THERE ARE SEVERAL REASONS WHY I BELIEVE KENTUCKY HAS THE BEST ENTERPRISE ZONE LAW AMONG THE STATES.

1. BY SETTING A LIMIT ON THE NUMBER OF ENTERPRISE ZONES THAT WILL BE DESIGNATED AT THE STATE LEVEL TO SEVEN IN FOUR YEARS, AT THE RATE OF TWO A YEAR, WE HAVE ESTABLISHED A PROCESS WHEREBY THOSE AREAS OF THE COMMONWEALTH THAT DESIRE DESIGNATION WILL HAVE TO COMPETE FOR DESIGNATION. IN DECIDING WHO WILL BE DESIGNATED, THE STATE WILL GIVE PREFERENCE TO THOSE COMMUNITIES THAT DEMONSTRATE THE GREATEST LOCAL COMMITMENT TO MAKING AN ENTERPRISE ZONE WORK AND MAKING IT ATTRACTIVE TO BUSINESS. THE STATE MUST GIVE PREFERENCE TO THOSE AREAS WHICH HAVE WIDEST SUPPORT FROM THE COMMUNITY, THE RESIDENTS,

LOCAL BUSINESSES, PRIVATE ORGANIZATIONS AND THE LOCAL GOVERNMENT SEEKING DESIGNATION AS EVIDENCED BY THEIR EFFORTS TO ENCOURAGE ECONOMIC ACTIVITY AND REMOVE IMPEDIMENTS TO JOB CREATION, INCLUDING A LOCAL REDUCTION OF TAX RATES OR FEES, AN INCREASE IN THE LEVEL OF EFFICIENCY OF GOVERNMENT SERVICES AND A STREAMLINING OF GOVERNMENTAL REQUIREMENTS ON EMPLOYERS OR EMPLOYEES. I BELIEVE THIS ELEMENT OF LOCAL COMMITMENT IS ESSENTIAL TO THE SUCCESS OF ENTERPRISE ZONES. FROM A FEDERAL PERSPECTIVE STATE COMMITMENT TO THE CONCEPT OF ENTERPRISE ZONES IS ALSO ESSENTIAL. IN THE ENACTMENT OF KENTUCKY'S ENTERPRISE ZONE LAW, I BELIEVE WE HAVE TAKEN A STRONG FIRST STEP IN DEMONSTRATING OUR COMMITMENT.

2. KENTUCKY'S LAW CLOSELY PARALLELS THE CRITERIA FOR ELIGIBILITY SET OUT IN THE FEDERAL PROPOSALS. IN ORDER TO QUALIFY FOR STATE DESIGNATION AS AN ENTERPRISE ZONE, THE AREA MUST HAVE A CONTINUOUS BOUNDARY, MUST BE DECLARED AN "ECONOMICALLY DEPRESSED AREA" BY THE LOCAL GOVERNMENT AND MUST BE AN AREA OF PERVASIVE POVERTY, UNEMPLOYMENT AND ECONOMIC DISTRESS AS EVIDENCE BY AN UNEMPLOYMENT RATE OF 1 1/2 TIMES THE NATIONAL AVERAGE, AND AT LEAST 70% OF THE RESIDENTS OF THE AREA HAVE INCOMES

BELOW 80% OF MEDIAM INCOME OF THE COMMUNITY OR THE POPULATION OF THE AREA HAS DECREASED BY 10% OR MORE OVER THE PAST TEN YEARS. OUR LAW HAS NO MINIMUM POPULATION REQUIREMENT. IN DRAFTING OUR LEGISLATION WE WERE CAREFUL NOT TO INVOKE ANY STANDARD WHICH MIGHT PRECLUDE RURAL AREAS OF THE COMMONWEALTH FROM QUALIFYING. THERE ARE AREAS OF EASTERN KENTUCKY IN PARTICULAR THAT MEET THESE CRITERIA AND PERHAPS RIVAL THE POVERTY, UNEMPLOYMENT AND ECONOMIC DISTRESS OF MANY OF THIS NATION'S WORST INNER CITY AREAS. THE ECONOMY OF APPALACHIAN KENTUCKY HAS BEEN GUIDED BY A BOOM AND BUST CYCLE IN THE COAL INDUSTRY FOR OVER THREE DECADES. A STRONG, LASTING ECONOMY FOR EASTERN KENTUCKY REQUIRES DIVERSIFICATION OF THE ECONOMY. AS GOVERNOR, I HAVE BEEN ENCOURAGING THE USE OF REVENUES GENERATED BY THE COAL INDUSTRY FOR ECONOMIC DEVELOPMENT. WE SEE A TREMENDOUS POTENTIAL FOR THE ENTERPRISE ZONE CONCEPT TO HELP IN THE EFFORT TO DIVERSIFY THE APPALACHIAN ECONOMY.

3. THIRD, IS IN THE AREA OF REGULATORY RELIEF, AN IMPORTANT ELEMENT IN THE EFFORT TO ENCOURAGE NEW BUSINESS ACTIVITY IN ENTERPRISE ZONES. RATHER THAN SPECIFY PARTICULAR AREAS FOR RELIEF, KENTUCKY'S LAW PROVIDES A VEHICLE FOR SCRUTINIZING ALL AREAS OF GOVERNMENT REGULATIONS. OUR LAW IS SIMILAR TO FEDERAL PROPOSALS IN THIS REGARD. OUR LAW PROVIDES THAT ANY STATE AGENCY WHICH PROMULGATES ADMINISTRATIVE REGULATIONS MAY EXEMPT ENTERPRISE ZONES FROM THE EFFECT OF THOSE REGULATIONS. NO ZONE MAY BE EXEMPTED FROM A REGULATION IF THE EXEMPTION WOULD ENDANGER PUBLIC HEALTH AND SAFETY, BUT NO AREA OF REGULATION WILL BE EXEMPT FROM SCRUTINY. IN EFFECT, ENTERPRISE ZONES CAN BECOME A TESTING GROUND, ON A LIMITED BASIS, FOR IDENTIFYING THOSE AREAS OF GOVERNMENT REGULATION WHICH MAY HAVE BECOME AN UNNECESSARY BURDEN TO BUSINESS OR BARRIER TO ECONOMIC GROWTH. WE HAVE ALSO PLACED SAFE GUARDS IN THIS SYSTEM FOR PROVIDING REGULATORY RELIEF. A PROPOSAL TO EXEMPT ZONES FROM REGULATIONS WOULD COME FROM THE AGENCY WHICH PROMULGATES THOSE REGULATIONS AND WOULD TAKE EFFECT ONLY AFTER PROPER PUBLIC NOTICE OF INTENT TO GRANT AN EXEMPTION, A PUBLIC HEARING AND FINAL REVIEW BY A SUBCOMMITTEE OF THE KENTUCKY GENERAL ASSEMBLY.

ONE AREA OF KENTUCKY'S LAW THAT IS SPECIFIC ARE THE TAX INCENTIVES AVAILABLE TO QUALIFIED BUSINESSES WITHIN A ZONE. THESE TAX INCENTIVES ARE:

1. REMOVAL OF THE SALES TAX ON BUILDING MATERIALS AND NEW AND USED EQUIPMENT AND MACHINERY USED IN A ZONE.

2. ELIMINATION OF THE CAPITAL GAIN'S TAX ON PROPERTY IN A ZONE.

3. REMOVAL OF THE TAX ON INTEREST INCOME ON LOANS MADE TO A ZONE.

4. REMOVAL OF THE MOTOR VEHICLE USAGE TAX ON VEHICLES PURCHASED AND USED BY QUALIFIED BUSINESSES WITHIN A ZONE.

5. EXTENDING THE LOSS CARRY FORWARD PERIOD WHICH IS SEVEN YEARS UNDER KENTUCKY LAW TO 20 YEARS OR THE LIFE OF A ZONE.

6. AUTHORITY FOR THE LOCAL GOVERNMENT TO REDUCE PROPERTY TAX RATES ON THE NON SCHOOL PORTION OF PROPERTY TAX REVENUES TO ONE MIL PER $100 VALUATION OR ALMOST NOTHING. LOCAL GOVERNMENTS MUST DECIDE WHETHER TO REDUCE PROPERTY TAXES UNDER THIS PROVISION AND THE STATE MUST CONSIDER THEIR FINANCIAL CAPACITY TO DO SO IN REVIEWING THEIR APPLICATION FOR DESIGNATION AS AN ENTERPRISE ZONE.

REMOVAL OF THE SALES TAX ON BUILDING MATERIALS, EQUIPMENT AND MACHINERY IS DESIGNED TO ENCOURAGE BUSINESS START-UPS AND EXPANSION. ELIMINATION OF THE CAPITAL GAINS TAX AND THE TAX ON INTEREST INCOME IS DESIGNED TO ENCOURAGE CAPITAL INVESTMENT IN A ZONE. THE LACK OF AVAILABLE CAPITAL IS A MAJOR IMPEDIMENT TO THE CREATION OF NEW SMALL BUSINESSES. THE EXTENDED LOSS CARRY FORWARD PERIOD PERMITS GREATER FLEXIBILITY IN BALANCING OUT TAX LIABILITIES AGAINST BAD BUSINESS YEARS AT TIMES THAT MAY BE CRITICAL TO THE CONTINUED SUCCESS OF A SMALL BUSINESS.

IN GENERAL, THE TAX INCENTIVES OFFERED TO QUALIFIED BUSINESSES ARE NOT DESIGNED TO GIVE THEM A COMPETITIVE ADVANTAGE, BUT RATHER TO GENERATE NEW BUSINESS ACTIVITY IN AREAS WHERE LITTLE SUCH ACTIVITY PRESENTLY OCCURS. SPECIAL INCENTIVES ARE NECESSARY TO ENCOURAGE BUSINESSES TO LOCATE IN THESE IMPROVERISHED AREAS AND TO ENCOURAGE THEM TO TAKE PART IN THE REVITALIZATION EFFORTS. LOCATION IN A ZONE DOES NOT AUTOMATICALLY MEAN A BUSINESS WILL QUALIFY FOR THE TAX AND REGULATORY RELIEF. EVEN THOUGH IT MAY BE LOCATED WITHIN THE BOUNDARIES OF A ZONE, TO BE CERTIFIED A QUALIFIED BUSINESS AND THUS ELIGIBLE FOR THE BENEFITS OF THE LAW, A BUSINESS MUST HAVE AT LEAST ONE HALF OF ALL ITS EMPLOYEES WORKING IN THE ZONE AND ONE FOURTH OF ALL ITS EMPLOYEES MUST BE RESIDENTS OF THE ZONE OR HAVE BEEN UNEMPLOYED OR ON PUBLIC ASSISTANCE FOR A YEAR.

KENTUCKY'S ENTERPRISE ZONE LEGISLATION WAS THE PRODUCT OF A 27 MEMBER COMMITTEE APPOINTED LAST SPRING. TWO STATE REPRESENTATIVES, ONE A REPUBLICAN FROM THE BUSINESS SECTOR, THE OTHER A LABOR DEMOCRAT FROM EASTERN KENTUCKY WERE APPOINTED CO-CHAIRMEN. THE COMMITTEE WAS MADE UP OF A CROSS SECTION OF INTERESTS---LABOR, BUSINESS, THE MUNICIPAL LEAGUE, ECONOMIC DEVELOPMENT AGENTS FOR LOCAL GOVERNMENTS, STATE LEGISLATORS AND MY COMMISSIONERS FOR THE DEPARTMENTS OF REVENUE; HOUSING BUILDINGS AND CONSTRUCTION, COMMUNITY DEVELOPMENT, NATURAL RESOURCES, VOCATIONAL EDUCATION AND LABOR. DURING THE COURSE OF THEIR ACTIVITIES THE COMMITTEE HEARD FROM SEVERAL GUEST SPEAKERS INCLUDING CONGRESSMAN RON MAZZOLI, MARY MCCONNELL FROM CONGRESSMAN KEMP'S STAFF AND MR. EDGAR VASH OF THE AMERICAN LEGISLATIVE EXCHANGE COUNCIL. THE LEGISLATION THEY DRAFTED RECEIVED BROAD BI-PARTISAN SUPPORT IN THE GENERAL ASSEMBLY WHICH ADJOURNED JUST LAST WEEK. IT PASSED THE HOUSE OF REPRESENTATIVES 93-2 AND THE SENATE 30-2. I SIGNED IT INTO LAW ON MARCH 26.

THE COMMITTEE APPROACH TO DRAFTING OUR LEGISLATION NOT ONLY ALLOWED THE VARIOUS INTERESTS INVOLVED TO PARTICIPATE IN THE FORMULATION OF THE LAW, BUT PERMITTED THESE INTERESTS TO BE EDUCATED IN THE CONCEPT BEHIND ENTERPRISE ZONES. WE BELIEVE THE IMPLEMENTATION OF OUR LAW WILL BE EASIER BECAUSE OF IT.

Senator **Chafee**. Governor, do you have any of these zones yet? Or are you waiting for the Federal zones and then you will have your rules effective in the Federal zone? Is that right?

Governor **Brown**. Well, the legislation just passed 2 weeks ago.

Senator **Chafee**. Oh, I see.

Governor **Brown**. It calls for seven zones over a 4-year period.

Senator **Chafee**. Would you go ahead without this legislation anyway?

Governor **Brown**. I think we can try; but I think we will be limited as far as the return, the results we will get, because the big tax incentives have to come from the Federal level.

Senator **Chafee**. I see.

Senator Bradley?

Senator **Bradley**. Mr. Chairman, I was interested only if there was a working zone. And in answer to the previous question you said that there are no zones because the law was just passed.

Governor **Brown**. That's right.

Senator **Bradley**. Thank you.

Governor **Brown**. We will have a nine-member authority that will be set up to approve the zones.

Senator **Bradley**. In your deliberations, how are you certain that the zones will create jobs for the citizens of the particular urban center? The concern that we hear frequently is that the jobs will be created but that the people will come in from the suburbs for the jobs. Then you will still have a core unemployment rate that is intolerably high in the urban area.

Governor **Brown**. Well, in order to qualify, 25 percent of the people have to live there; 50 percent of the people have to work there.

Senator **Bradley**. Under your State program, 25 percent of the workers have to live in the zone?

Governor **Brown**. Yes, sir.

Senator **Bradley**. And 50 percent?

Governor **Brown**. Fifty percent of the people have to work in the zone.

Senator **Chafee**. Fifty percent of the people in the plan?

Governor **Brown**. Yes, sir.

Senator **Chafee**. To get the advantage of it, they have to come from the zone?

Governor **Brown**. They have to work in the zone. In other words, you couldn't set up a sales operation and, I guess, market outside of your territory or distribute outside of your territory. You would have to actually operate within the zone.

Senator **Bradley**. Was there any reason or rationale for picking 25 percent living in and 50 percent——

Governor **Brown**. I think just to assure that you are going to create jobs for that zone area.

One other program that is very essential, I think, to creating jobs for those who live in the zone is your training program, to train people to be specialized in whatever industry is going to be developed. We have concentrated very heavily on our vocational educational program.

Senator **Bradley**. Now, would that training program take place inside the zone?

Governor **Brown**. Or have close access to it, yes. We use our community colleges; we use our high schools; and we can have mobile programs as well.

Senator **Bradley**. Do you have a program in Kentucky where a company tells you they will build in the zone, but they need 32 plumbers and 46 computer operators, and then the State takes care of the training of those people?

Governor **Brown**. Yes, sir. We do everything but wake you up and put you to bed. [Laughter.]

Senator **Bradley**. That's all, Mr. Chairman.

Senator **Chafee**. All right; Senator Huddleston?

Senator **Huddleston**. I have no questions.

Senator **Chafee**. Thank you very much, Governor. We appreciate your coming.

Governor **Brown**. Thank you.

[The prepared statement follows:]

TESTIMONY OF
THE HONORABLE JOHN Y. BROWN, JR.
GOVERNOR OF THE COMMONWEALTH OF KENTUCKY

I am pleased to appear today on behalf of the National Governors' Association (NGA) to discuss proposals to create enterprise zones. I am here as Chairman of NGA's Task Force on Small Business of the Committee on Community and Economic Development and the States' Co-Chairman of the Appalachian Regional Commission.

First, let me commend the Chairman, the Committee, Senator Danforth, and Senator Boschwitz for your pursuance of the novel concept of rejuvenating specific distressed areas and creating jobs by encouraging and letting loose the fetters on the free enterprise system. I have been impressed by your receptiveness to new ideas and to suggestions for improvements from the original draft legislation.

I am encouraged that you have taken an interest in existing small business in enterprise zones. David Birch of M.I.T. wrote of the importance of small business in creating new jobs. He concluded in his report entitled "The Job Generation Process" that "small firms (those with 20 or fewer employees) generate 66% of all new jobs generated in the United States".

NGA sees definite possibilities for small businesses in enterprise zones. Enterprise zones are conceived of as geographic areas where the climate for investment can be improved by a series of incentives and relaxed restrictions. This approach is designed to restore the commercial and industrial vitality of depressed areas in the States using the private sector as the chief resource. Properly nurtured through creative public-private partnerships, we think it can work. In Kentucky, I feel that the concept is applicable to areas as diverse as the rural, mountainous areas of Appalachia in eastern Kentucky and the urban area of the west end of Louisville.

The primary federal incentive offered by the various enterprise zone bills are tax reductions. Two incentives contained in S. 1310 will be of particular assistance to small business: a) the elimination of the capital gains tax and b) provisions for a refundable jobs tax credit. These two incentives will be especiall helpful to struggling new firms during their early years of existence. However, tax cuts and credits help all businesses, and don't really stimulate as much capital formation for smaller businesses which are in lower tax brackets and are less capital intensive. The largest financial need of small businesses is the steady infusion of new capital. While the continued availability of industrial revenue bonds for small business is essential, incentives to private investors who might provide venture and risk capital within the zones are also needed. One idea worth examining, found in S. 1829, permits investors in new, small enterprise zone firms to deduct their entire investments from their taxable income subject to a certain maximum amount, providing the money is kept in the firm for a minimum period. Another idea found in S. 1829 is a deduction to individuals for loaning money to qualified zone firms.

Beyond providing incentives for the provision of capital to small business, the Committee should address two other concerns of small business: 1) that existing small businesses within the zone will not be put at a disadvantage by new entrants, and 2) that small businesses outside of the zone will not be put at competitive disadvantages. To the extent possible, the program should encourage new business activity within the zone.

NGA agrees with the sponsors of S. 1310, S. 1829 and S. 2298 that an enterprise zone program should be treated as an experiment and conducted on a pilot basis. States are also enacting enterprise zone legislation on a test basis. We hope that during the program's life, extensive evaluations will be conducted both at the federal and State levels. As we all learn more about what incentives are effective, State and local government should have the opportunity to modify their incentives by increasing those that are effective and eliminating those which are not effective. Incentives that are found not to be effective in generating economic activity would only serve unnecessarily to drain off limited State and local resources.

Tax incentives, in and of themselves, are not sufficient to make the enterprise zone concept work. Starting a small business is a risky venture under the best of circumstances; locating a new enterprise in a severely distressed area poses nearly insurmountable odds. Increasing the survival rate of new, small firms in designated zones will require a coordinated package of services, investments and incentives to be provided by State and local governments in conjunction with federal programs and incentives. While specific development needs will vary from zone to zone, such things as improvements in public infrastructure, stepped-up law enforcement, housing, employment and training services, business loans and loan guarantees, and streamlined regulatory procedures can make a critical difference in the success of individual firms and the enterprise zone concept. We are convinced that States have a critical role to play in packaging these complementary services and investments, and in supplementing federal tax incentives.

Because of unique State constitutional requirements governing local powers and authorities, State governments need to be heavily involved in designating eligible zones, structuring State and local incentives, and overseeing the administration of zones within their jurisdictions. It is for this reason I would like to address the zone designation process.

NGA proposes an alternative designation process to those set forth in S. 1310 and S. 2298. Rather than having HUD designate 75 zones over a three-year period, based on a national competition, we would suggest that the States and territories select the zones -- both urban and rural -- based on federally established area and eligibility requirements. The NGA proposal would have the following advantages:

- Both urban and rural enterprise zones could be tested. Under S. 1310 and S. 2298, it is unlikely that many rural areas could successfully compete with urban areas.
- All States would receive at least one zone. Thus, the pressures to expand the program before the experiment was completed would be less, for example, than in the EDA program.
- State designation avoids the possibility that HUD discretion would open the door to political pressures on HUD and charges of favoritism against it.

- Local zone designations would be consistent with State-wide development plans and priorities.

- Neighboring jurisdictions would be less likely to have to compete for a zone designation.

- Chances of intra-State "pirating" of businesses and jobs from one locality to another would be less.

- It is likely that fewer applications and paperwork would be generated.

- State and local governmental officials would have to expend less political capital in producing an application. Local officials would have a better chance to gain designation approval.

NGA supports, as a matter of policy, local responsibility for the routine planning, management and delivery of substate development programs. Consistent with this position, administrative responsibility for the day-to-day operation of designated enterprise zones should be vested with local units of government, wherever feasible. At the same time, State governments can play a constructive role in providing needed monitoring, oversight, and technical assistance to local zone authorities. This oversight role for States is particularly essential with regard to coordination, streamlining, and simplification of State and local regulatory requirements and permitting procedures in such areas as environmental impacts, water and sewer permits, construction codes, and zoning and land use regulations.

States are excited about the enterprise zone concept. Eight States have already enacted enterprise zone legislation. They are Connecticut, Florida, Louisiana, Maryland, Minnesota, Ohio, Virginia, and my own State of Kentucky. Over thirty States have bills pending in their legislatures and the States of Illinois, Indiana and Oregon have study commissions evaluating the concept or drafting legislation. NGA and the States welcome complementary federal legislation which will supplement State initiatives.

In conclusion, we believe the enterprise zone concept is a potentially useful tool for fostering entrepreneurship, business development, and job creation in economically distressed areas. We hope that as you continue to explore and refine this concept, you will consider it in the context of a renewed commitment to federalism. State governments can and should play a positive and constructive role in ensuring the success of this program in achieving an economic resurgence of blighted inner city neighborhoods as well as distressed small and medium-sized communities. We look forward to working with you in a cooperative way during the months ahead to help fashion a workable and successful enterprise zone program.

Senator CHAFEE. Mr. Norris is here, and I would like to hear from him at this time because of the time constraint he is working under. And then we will go to the next panel of the mayors.

Mr. Norris, we welcome you. You have practiced what we are preaching. We would be interested in your experiences.

STATEMENT OF WILLIAM C. NORRIS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CONTROL DATA CORP., MINNEAPOLIS, MINN.

Mr. NORRIS. Thank you.

Mr. Chairman and members of the subcommittee, I am pleased to have this opportunity to present my views about the Enterprise Zone Act of 1982. We at Control Data are keenly interested in legislation to help create jobs and in other ways to facilitate revitalization of blighted urban and rural areas. These have long been important objectives for Control Data. For more than a decade our corporation in cooperation with government and other sectors has been addressing these and other major unmet needs of society as profitable business opportunities.

Our programs cover a wide spectrum, including the establishment of plants in poverty-stricken areas, providing higher quality, less costly, and more accessible education and training in schools, communities, and prisons, helping small business, and revitalizing urban and rural communities. We work in the toughest of environments.

I should emphasize the point about cooperation. The major unmet needs of society are massive in size; therefore, massive resources far beyond those of a single organization are required to meet them. Hence, the need for cooperation—for partnerships reaching down to the neighborhood level.

For example, to be most effective in urban revitalization, Control Data joined with 10 other companies and two church organizations to form a consortium called City Venture, which is an efficient pooling of the resources of individual members. City Venture plans and manages the implementation of programs for the revitalization of urban communities.

City Venture has been in existence for 3 years and has a number of urban revitalization projects underway. The most advanced City Venture project is in the Warren-Sherman community of Toledo, Ohio. It is the Nation's most extensive public-private sector cooperation for inner-city revitalization which is guided by a holistic plan for development.

In Warren-Sherman, small businesses are being started, jobs are being created, disadvantaged residents are being trained and employed, housing and education in the high school are being improved. Progress has been excellent.

The City Venture approach works, but it needs additional support to assure that its full potential is reached in Warren-Sherman and that replication occurs on a national scale. Enterprise zone legislation, properly structured, can provide such support. S. 2298 is a step in the right direction, but it doesn't go far enough.

Let me describe important improvements which are needed. They include: Comprehensive planning; more support for small business formation and growth; more support for community organizations; and training.

In elaborating on these important and interrelated categories, I will start with the need for comprehensive planning.

Successful revitalization efforts require a comprehensive plan which brings to bear available public and private resources in a cooperative approach. Experience shows that development problems of urban and rural areas are multifaceted; thus, they do not lend themselves to piecemeal or one-dimensional solutions.

Regrettably, past efforts to reverse decline in these areas have usually focused on only one aspect of the problem—typically, "bricks and mortar" or capital formation—without addressing the total situation. For example, it makes no sense to devote resources to rebuilding housing unless people have income from jobs to maintain the housing.

In order to encourage localities to utilize comprehensive plans for enterprise zone revitalization, I recommend that S. 2298 be amended to include such plans in the list of criteria used to judge local applications for zone designation.

The main source of new jobs will be small business. Governor Brown emphasized this point. Yet, most of the resources for creating jobs—technology, management experience, and capital—reside in big business. Studies also show that four-fifths of all new businesses fail within the first 5 years. Hence, big business must be stimulated to collaborate with small business, and other actions must be taken to create a total environment conducive to a success of small firms.

There are a number of specific ways to encourage the formation and growth of small businesses in enterprise zones. The most critical area is financing.

Seed capital is ordinarily not available to small companies in distressed areas. MESBIC's and SBIC's have helped small businesses but there are still major gaps. Investors are wary of committing funds to high-risk fledgling ventures with long-term and uncertain payout periods. Even if all the incentives in the proposed legislation were in place, new zone businesses would still face the reluctance of lenders to invest in high risk ventures in high-risk areas.

Unless entrepreneurs can access this seed capital, they will be unable to get started and generate new employment. Large businesses, financial institutions, and individuals must be stimulated to invest in small businesses in order to help assure successful startups and profitable growth.

The exclusion from taxation of 50 percent interest of the income from loans to enterprise zone firms in the original Chafee-Boschwitz bill was a good start. I would urge consideration of something even more substantial—namely, a 100-percent writeoff for new equity investment in small zone firms up to some reasonable limit. An immediate tax benefit for new investors would be superior to the elimination of capital gains taxes as proposed in the bill, because the incentive to investors would be more immediate and not dependent on the short-term profitability of the enterprise.

By aiming the incentive at the investor rather than the business, which typically has a negligible tax liability, the 100 percent deduction would remove the biggest obstacle to private enterprise in distressed areas—the lack of startup capital—and would offset the perceived negative advantages associated with investing in enterprise zones.

The potential for abuse of a 100-percent writeoff plan could be minimized by limiting the deduction to something like $100,000 per investor and $1 million per enterprise, qualifying the equity of zone small businesses only and requiring some minimum holding period.

Senator CHAFEE. And you would then keep the capital gains in there, I presume, so the Government would get something out of it?

Mr. NORRIS. Well, that would be up to the drafters of the bill. I think it would be a good idea.

Senator CHAFEE. To keep the capital gains tax in?

Mr. NORRIS. Yes.

With respect to technology, tax credits should be established to induce large companies to make their unused or underutilized technologies available to small companies. There is an enormous volume of such technologies; however, there are costs involved in their identification and transfer. Therefore, a provision is recommended that would exempt from taxation 50 percent of the income, up to a maximum exemption of $350,000 earned from the sale or license of a technology to a zone small business.

Another area of great importance to small businesses is efficient access to facilities and services. Experience teaches that the chances for survival and attainment of early profitable growth are greatly enhanced by establishing a magnet facility which provides high quality technical and management training, purchasing, contracting, many other services, and shared facilities such as laboratory, office space, and so on. Economies of scale make it possible to provide these shared facilities and services at costs considerably lower than each individual enterprise would be capable of obtaining independently. This is why these magnet facilities are often referred to as "incubators" for small businesses.

The payout period for one of these entrepreneurial development centers is typically 8 to 10 years. Since this is perceived by most investors as too long, a special investment tax credit of 15 percent over and above any existing credit is recommended for expenses incurred in building or rehabilitating entrepreneurial development centers.

Experience also shows that community organizations have a major role in assisting small business in addition to performing other services that foster neighborhood revitalization.

One particularly effective example of a community organization providing assistance in creating jobs is called a cooperation office. It is a nonprofit public/private cooperative effort which addresses one of the greatest weaknesses of small companies—the lack of management ability. The cooperation office has a board of directors comprised of leaders from all major sectors of society, a small permanent staff, and, very important, a volunteer advisory panel of engineers, scientists, and executives.

The approach is simple: An entrepreneur has an idea for a new product or service and wants to start a company; the cooperation office helps develop an effective business plan and obtain initial financing.

The first cooperation office was established in Minnesota 3 years ago. Its success has been demonstrated, and it is being replicated in other communities. Currently, the Minnesota Cooperation Office is financed by contributions and grants, but it has been very difficult and time-consuming to obtain the necessary financing.

The cooperation office is but one example of a community organization assisting in the expansion of employment by helping small businesses which create most of the new jobs. Other community organizations important to employment include those involved in education and training, counseling and day care. Virtually all of these organizations are chronically short of funds, particularly now. Accordingly, the enterprise zone legislation needs to include tax incentives to encourage contributions to those community organizations engaged in activities primarily related to employment.

We realize, of course, that such a provision must be drafted very carefully. Cities or localities applying for zone designations could certify the particular community based organizations which are participating in employment related activities. Then, if the city were one of those selected by HUD, contributions or other assistance or services provided to such organizations would qualify for certain tax incentives such as a 25-percent tax credit. Such contributions would, of course, remain tax deductible.

I might add, Mr. Chairman, that the Senator from Pennsylvania, Mr. Specter, has introduced a bill, S. 2224, which would allow a credit of 20 percent for contributions to nonprofit organizations providing job training for handicapped and disadvantaged persons. This is the type of legislation we have in mind.

The last category for review is training. In our experience, locating plants in inner-city areas and with urban and rural revitalization confirms that there are substantial additional costs associated with hiring and training those with little or no work experience or job-related skills.

Although the 7-year employer tax credit proposed by S. 2298 is a considerable improvement over the current targeted jobs tax credit program, the enterprise zone legislation must do more than just provide job tax credit. To assure that there is an adequate job training component in each enterprise zone, this legislation should be linked in some way to the emerging job training legislation. Perhaps the Secretary of Labor could be authorized to make special job training grants to areas designated as enterprise zones, perhaps on a matching basis with local governments. Most local governments could be given special consideration for zone designation if they agreed to include a fund for a training component in that application package.

The main objective is to get disadvantaged persons into a career path. This usually requires both job preparation training and later on-the-job training. The Government funds would be used for preemployment training, and the tax credit would provide not only the means for additional training after employment but also the incentive to provide that extra effort required to get a disadvantaged person into a career path and not just a short-term job.

In conclusion, let me just say that the time is long overdue to take effective steps to rebuild our poverty-stricken urban and rural areas. We know how to do it, but incentives are lacking which will attract the public/private partnerships in place that are necessary for success.

Properly structured, and as a supplement to existing private and public tools and entities currently engaged in current development, enterprise zone legislation can provide the incentives. There are attractive benefits for all in a properly conceived program. The modest cost to the Government will be recovered many times. A large number of badly needed jobs will be created, and attractive profits can be made by those who invest in the revitalization efforts. And that represents the American enterprise system functioning in the finest way.

Thank you.

[The prepared statement follows:]

Testimony of William C. Norris
Chairman, Control Data Corporation
April 21, 1982

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, I AM PLEASED TO HAVE THIS OPPORTUNITY TO PRESENT MY VIEWS ABOUT S.2298, "THE ENTERPRISE ZONE ACT OF 1982." WE AT CONTROL DATA ARE KEENLY INTERESTED IN LEGISLATION TO HELP CREATE JOBS AND IN OTHER WAYS TO FACILITATE REVITALIZATION OF BLIGHTED URBAN AND RURAL AREAS.

THESE HAVE LONG BEEN IMPORTANT OBJECTIVES FOR CONTROL DATA. FOR MORE THAN A DECADE, OUR CORPORATION IN COOPERATION WITH GOVERNMENT AND OTHER SECTORS HAS BEEN ADDRESSING THESE AND OTHER MAJOR UNMET NEEDS OF SOCIETY AS PROFITABLE BUSINESS OPPORTUNITIES.

OUR PROGRAMS COVER A WIDE SPECTRUM, INCLUDING THE ESTABLISHMENT OF PLANTS IN POVERTY-STRICKEN AREAS, PROVIDING HIGHER QUALITY, LESS COSTLY AND MORE ACCESSIBLE EDUCATION AND TRAINING IN SCHOOLS, COMMUNITIES AND PRISONS, HELPING SMALL BUSINESS, AND REVITALIZING URBAN AND RURAL COMMUNITIES. WE WORK IN THE TOUGHEST OF ENVIRONMENTS.

I SHOULD EMPHASIZE THE POINT ABOUT COOPERATION. THE MAJOR UNMET NEEDS OF SOCIETY ARE MASSIVE IN SIZE; THEREFORE, MASSIVE

RESOURCES FAR BEYOND THOSE OF A SINGLE ORGANIZATION ARE REQUIRED TO MEET THEM. HENCE THE NEED FOR COOPERATION -- FOR PARTNERSHIPS REACHING DOWN TO THE NEIGHBORHOOD LEVEL.

FOR EXAMPLE, TO BE MOST EFFECTIVE IN URBAN REVITALIZATION, CONTROL DATA JOINED WITH TEN OTHER COMPANIES AND TWO CHURCH ORGANIZATIONS TO FORM A CONSORTIUM CALLED CITY VENTURE, WHICH IS AN EFFICIENT POOLING OF THE RESOURCES OF INDIVIDUAL MEMBERS. CITY VENTURE PLANS AND MANAGES THE IMPLEMENTATION OF PROGRAMS FOR THE REVITALIZATION OF URBAN COMMUNITIES.

CITY VENTURE HAS BEEN IN EXISTENCE FOR THREE YEARS AND HAS A NUMBER OF URBAN REVITALIZATION PROJECTS UNDERWAY. THE MOST ADVANCED CITY VENTURE PROJECT IS IN THE WARREN-SHERMAN COMMUNITY OF TOLEDO, OHIO. IT IS THE NATION'S MOST EXTENSIVE PUBLIC-PRIVATE SECTOR COOPERATION FOR INNER CITY REVITALIZATION WHICH IS GUIDED BY A HOLISTIC PLAN FOR DEVELOPMENT.

IN WARREN-SHERMAN, SMALL BUSINESSES ARE BEING STARTED, JOBS ARE BEING CREATED, DISADVANTAGED RESIDENTS ARE BEING TRAINED AND EMPLOYED, HOUSING AND EDUCATION IN THE HIGH SCHOOL ARE BEING IMPROVED. PROGRESS HAS BEEN EXCELLENT.

THE CITY VENTURE APPROACH WORKS, BUT IT NEEDS ADDITIONAL SUPPORT TO ASSURE THAT ITS FULL POTENTIAL IS REACHED IN WARREN-SHERMAN AND THAT REPLICATION OCCURS ON A NATIONAL SCALE. ENTERPRISE ZONE LEGISLATION, PROPERLY STRUCTURED, CAN PROVIDE SUCH SUPPORT. S.2298 IS A STEP IN THE RIGHT DIRECTION, BUT IT DOESN'T GO FAR ENOUGH.

LET ME DESCRIBE IMPORTANT IMPROVEMENTS WHICH ARE NEEDED. THEY INCLUDE:

- COMPREHENSIVE PLANNING
- MORE SUPPORT FOR SMALL BUSINESS FORMATION AND GROWTH
- MORE SUPPORT FOR COMMUNITY ORGANIZATIONS
- TRAINING

COMPREHENSIVE PLANNING

IN ELABORATING ON THESE IMPORTANT AND INTERRELATED CATEGORIES, I WILL START WITH THE NEED FOR COMPREHENSIVE PLANNING. SUCCESSFUL REVITALIZATION EFFORTS REQUIRE A COMPREHENSIVE PLAN WHICH BRINGS TO BEAR AVAILABLE PUBLIC AND PRIVATE RESOURCES IN A COOPERATIVE APPROACH. EXPERIENCE SHOWS THAT DEVELOPMENT PROBLEMS OF URBAN AND RURAL AREAS ARE MULTIFACETED; THUS, THEY DO NOT LEND THEMSELVES TO PIECEMEAL OR ONE-DIMENSIONAL SOLUTIONS. REGRETTABLY, PAST EFFORTS TO REVERSE DECLINE IN THESE AREAS HAVE USUALLY FOCUSED ON ONLY ONE ASPECT OF THE

PROBLEM (TYPICALLY, "BRICKS AND MORTAR" OR CAPITAL FORMATION) WITHOUT ADDRESSING THE TOTAL SITUATION. FOR EXAMPLE, IT MAKES NO SENSE TO DEVOTE RESOURCES TO REBUILDING HOUSING UNLESS PEOPLE HAVE INCOME FROM JOBS TO MAINTAIN THE HOUSING.

IN ORDER TO ENCOURAGE LOCALITIES TO UTILIZE COMPREHENSIVE PLANS FOR ENTERPRISE ZONE REVITALIZATION, I RECOMMEND THAT S.2298 BE AMENDED TO INCLUDE SUCH PLANS IN THE LIST OF CRITERIA USED TO JUDGE LOCAL APPLICATIONS FOR ZONE DESIGNATION.

SUPPORT FOR SMALL BUSINESS

THE MAIN SOURCE OF NEW JOBS WILL BE SMALL BUSINESS. STUDIES SHOW THAT 80% OF THE NEW JOBS CREATED DURING THE PAST 10 YEARS HAVE COME FROM SMALL BUSINESSES WITH 100 EMPLOYEES OR LESS. YET MOST OF THE RESOURCES FOR CREATING JOBS -- TECHNOLOGY, MANAGEMENT EXPERTISE AND CAPITAL RESIDE IN BIG BUSINESS. STUDIES ALSO SHOW THAT FOUR-FIFTHS OF ALL NEW BUSINESSES FAIL WITHIN THE FIRST FIVE YEARS. HENCE, BIG BUSINESS MUST BE STIMULATED TO COLLABORATE WITH SMALL BUSINESS AND OTHER ACTIONS MUST BE TAKEN TO CREATE A TOTAL ENVIRONMENT CONDUCIVE TO THE SUCCESS OF SMALL FIRMS. THERE ARE A NUMBER OF SPECIFIC WAYS TO ENCOURAGE THE FORMATION AND GROWTH OF SMALL BUSINESSES IN ENTERPRISE ZONES.

FINANCING: THE MOST CRITICAL AREA IS FINANCING. SEED CAPITAL IS ORDINARILY NOT AVAILABLE TO SMALL COMPANIES IN DISTRESSED AREAS. MESBICS AND SBICS HAVE HELPED SMALL BUSINESSES BUT THERE ARE STILL MAJOR GAPS. INVESTORS ARE WARY OF COMMITTING FUNDS TO HIGH-RISK FLEDGLING VENTURES WITH LONG-TERM AND UNCERTAIN PAYOUT PERIODS. EVEN IF ALL THE INCENTIVES IN THE PROPOSED LEGISLATION WERE IN PLACE, NEW ZONE BUSINESSES WOULD STILL FACE THE RELUCTANCE OF LENDERS TO INVEST IN HIGH RISK VENTURES IN HIGH-RISK AREAS.

UNLESS ENTREPRENEURS CAN ACCESS THIS SEED CAPITAL, THEY WILL BE UNABLE TO GET STARTED AND GENERATE NEW EMPLOYMENT. LARGE BUSINESSES, FINANCIAL INSTITUTIONS, AND INDIVIDUALS MUST BE STIMULATED TO INVEST IN SMALL BUSINESSES IN ORDER TO HELP ASSURE SUCCESSFUL STARTUPS AND PROFITABLE GROWTH.

THE EXCLUSION FROM TAXATION OF 50% INTEREST OF THE INCOME FROM LOANS TO ENTERPRISE ZONE FIRMS IN THE ORIGINAL CHAFFEE-BOSCHWITZ BILL WAS A GOOD START IN THIS DIRECTION. I WOULD URGE CONSIDERATION OF SOMETHING EVEN MORE SUBSTANTIAL - NAMELY, A 100% WRITEOFF FOR NEW EQUITY INVESTMENT IN NEW SMALL ZONE FIRMS UP TO SOME REASONABLE LIMIT.

AN IMMEDIATE TAX BENEFIT FOR NEW INVESTORS WOULD BE SUPERIOR TO THE ELIMINATION OF CAPITAL GAINS TAXES AS PROPOSED IN THE BILL, BECAUSE THE INCENTIVE TO INVESTORS WOULD BE MORE IMMEDIATE AND NOT DEPENDENT ON THE SHORT-TERM PROFITABILITY OF THE ENTERPRISE.

BY AIMING THE INCENTIVE AT THE INVESTOR RATHER THAN THE BUSINESS, WHICH TYPICALLY HAS A NEGLIGIBLE TAX LIABILITY, THE 100% DEDUCTION WOULD REMOVE THE BIGGEST OBSTACLE TO PRIVATE ENTERPRISE IN DISTRESSED AREAS -- THE LACK OF STARTUP CAPITAL -- AND WOULD OFFSET THE PERCEIVED NEGATIVE FACTORS ASSOCIATED WITH INVESTING IN ENTERPRISE ZONES.

THE POTENTIAL FOR ABUSE OF A 100% WRITEOFF PLAN COULD BE MINIMIZED BY LIMITING THE DEDUCTION TO $100,000 PER INVESTOR AND $1M PER ENTERPRISE, QUALIFYING THE EQUITY OF ZONE SMALL BUSINESSES ONLY AND REQUIRING SOME MINIMUM HOLDING PERIOD.

TECHNOLOGY: WITH RESPECT TO TECHNOLOGY, TAX CREDITS SHOULD BE ESTABLISHED TO INDUCE LARGE COMPANIES TO MAKE THEIR UNUSED OR UNDERUTILIZED TECHNOLOGIES AVAILABLE TO SMALL COMPANIES. THERE IS AN ENORMOUS VOLUME OF SUCH TECHNOLOGIES EXISTS; HOWEVER, THERE ARE COSTS INVOLVED IN THEIR IDENTIFICATION AND TRANSFER.

THEREFORE, A PROVISION IS RECOMMENDED THAT WOULD EXEMPT FROM TAXATION 50% OF THE INCOME, UP TO A MAXIMUM EXEMPTION OF $350,000 EARNED FROM THE SALE OR LICENSE OF A TECHNOLOGY TO ZONE SMALL BUSINESS.

EFFICIENT ACCESS TO FACILITIES & SERVICES: ANOTHER AREA OF GREAT IMPORTANCE TO SMALL BUSINESSES IS EFFICIENT ACCESS TO FACILITIES AND SERVICES. EXPERIENCE TEACHES THAT THE CHANCES FOR SURVIVAL AND ATTAINMENT OF EARLY PROFITABLE GROWTH ARE GREATLY ENHANCED BY ESTABLISHING A MAGNET FACILITY WHICH PROVIDES HIGH QUALITY TECHNICAL AND MANAGEMENT TRAINING; PURCHASING; CONTRACTING AND ENGINEERING CONSULTING; FINANCIAL; INSURANCE; LEGAL AND DATA PROCESSING SERVICES; AND SHARED FACILITIES SUCH AS LABS, OFFICE SPACE, AND TECHNICAL INFORMATION LIBRARIES. ECONOMIES OF SCALE MAKE IT POSSIBLE TO PROVIDE THESE SHARED FACILITIES AND SERVICES AT COSTS CONSIDERABLY LOWER THAN EACH INDIVIDUAL ENTERPRISE WOULD BE CAPABLE OF OBTAINING INDEPENDENTLY. THIS IS WHY THESE MAGNET FACILITIES ARE OFTEN REFERRED TO AS "INCUBATORS" FOR SMALL BUSINESSES.

THE PAYOUT PERIOD FOR ONE OF THESE ENTREPRENEURIAL DEVELOPMENT CENTERS IS TYPICALLY EIGHT TO TEN YEARS. SINCE THIS IS PERCEIVED BY MOST INVESTORS AS TOO LONG, A SPECIAL INVESTMENT

TAX CREDIT OF 15% OVER AND ABOVE ANY EXISTING CREDIT IS RECOMMENDED FOR EXPENSES INCURRED IN BUILDING OR REHABILITATING ENTREPRENEURIAL DEVELOPMENT CENTERS.

COMMUNITY ORGANIZATIONS: EXPERIENCE ALSO SHOWS THAT COMMUNITY ORGANIZATIONS HAVE A MAJOR ROLE IN ASSISTING SMALL BUSINESS IN ADDITION TO PERFORMING OTHER SERVICES THAT FOSTER NEIGHBORHOOD REVITALIZATION.

ONE PARTICULARLY EFFECTIVE EXAMPLE OF A COMMUNITY ORGANIZATION PROVIDING ASSISTANCE IN CREATING JOBS IS A COOPERATION OFFICE. IT IS A NON-PROFIT PUBLIC/PRIVATE COOPERATIVE EFFORT WHICH ADDRESSES ONE OF THE GREATEST WEAKNESSES OF SMALL COMPANIES -- THE LACK OF MANAGEMENT ABILITY. THE COOPERATION OFFICE HAS A BOARD OF DIRECTORS COMPRISED OF LEADERS FROM ALL MAJOR SECTORS OF SOCIETY; A SMALL PERMANENT STAFF; AND A VOLUNTEER ADVISORY PANEL OF ENGINEERS, SCIENTISTS AND EXECUTIVES.

THE APPROACH IS SIMPLE: AN ENTREPRENEUR HAS AN IDEA FOR A NEW PRODUCT OR SERVICE AND WANTS TO START A COMPANY; THE COOPERATION OFFICE HELPS DEVELOP AN EFFECTIVE BUSINESS PLAN AND OBTAIN INITIAL FINANCING.

THE FIRST COOPERATION OFFICE WAS ESTABLISHED IN MINNESOTA THREE YEARS AGO. ITS SUCCESS HAS BEEN DEMONSTRATED, AND IT IS BEING REPLICATED IN OTHER COMMUNITIES. CURRENTLY, THE MINNESOTA COOPERATION OFFICE IS FINANCED BY CONTRIBUTIONS AND GRANTS, BUT IT HAS BEEN VERY DIFFICULT AND TIME-CONSUMING TO OBTAIN THE NECESSARY FINANCING.

THE COOPERATION OFFICE IS BUT ONE EXAMPLE OF A COMMUNITY ORGANIZATION ASSISTING IN THE EXPANSION OF EMPLOYMENT BY HELPING THE SMALL BUSINESSES WHICH CREATE MOST OF THE NEW JOBS. OTHER COMMUNITY ORGANIZATIONS IMPORTANT TO EMPLOYMENT INCLUDE THOSE INVOLVED IN EDUCATION AND TRAINING, COUNSELING AND DAY CARE. VIRTUALLY ALL OF THESE ORGANIZATIONS ARE CHRONICALLY SHORT OF FUNDS, PARTICULARLY NOW. ACCORDINGLY, THE ENTERPRISE ZONE LEGISLATION NEEDS TO INCLUDE TAX INCENTIVES TO ENCOURAGE CONTRIBUTIONS TO THOSE COMMUNITY ORGANIZATIONS ENGAGED IN ACTIVITIES PRIMARILY RELATED TO EMPLOYMENT.

WE REALIZE, OF COURSE THAT SUCH A PROVISION MUST BE DRAFTED VERY CAREFULLY. CITIES OR LOCALITIES APPLYING FOR ZONE DESIGNATIONS COULD CERTIFY THE PARTICULAR COMMUNITY-BASED ORGANIZATIONS WHICH ARE PARTICIPATING IN EMPLOYMENT RELATED ACTIVITIES. THEN, IF THE CITY WERE ONE OF THOSE SELECTED BY HUD, CONTRIBUTIONS OR OTHER ASSISTANCE OR SERVICES PROVIDED TO

SUCH ORGANIZATIONS WOULD QUALIFY FOR CERTAIN TAX INCENTIVES -- SUCH AS A 25% TAX CREDIT. SUCH CONTRIBUTIONS WOULD, OF COURSE, REMAIN TAX DEDUCTIBLE.

I MIGHT ADD, MR. CHAIRMAN, THAT THE SENATOR FROM PENNSYLVANIA, MR. SPECTER, HAS INTRODUCED A BILL S.2224, WHICH WOULD ALLOW A CREDIT OF 20% FOR CONTRIBUTIONS TO NON-PROFIT ORGANIZATIONS PROVIDING JOB TRAINING FOR HANDICAPPED AND DISADVANTAGED PERSONS. THIS IS THE TYPE OF LEGISLATION WE HAVE IN MIND TO INSURE THAT LOCAL NEIGHBORHOOD ORGANIZATIONS ARE FULL AND EQUAL PARTNERS IN ENTERPRISE ZONE REHABILITATION.

TRAINING

THE LAST CATEGORY FOR REVIEW IS TRAINING. OUR EXPERIENCE IN LOCATING PLANTS IN INNER CITY AREAS AND WITH URBAN AND RURAL REVITALIZATION CONFIRMS THAT THERE ARE SUBSTANTIAL ADDITIONAL COSTS ASSOCIATED WITH HIRING AND TRAINING THOSE WITH LITTLE OR NO WORK EXPERIENCE OR JOB RELATED SKILLS.

ALTHOUGH THE 7 YEAR EMPLOYER TAX CREDIT PROPOSED BY S.2298 IS A CONSIDERABLE IMPROVEMENT OVER THE CURRENT TARGETED JOBS TAX CREDIT PROGRAM, THE ENTERPRISE ZONE LEGISLATION MUST DO MORE THAN JUST PROVIDE JOB TAX CREDIT. TO ASSURE THAT THERE IS AN ADEQUATE JOB TRAINING COMPONENT IN EACH ENTERPRISE ZONE, THIS

LEGISLATION SHOULD BE LINKED IN SOME WAY TO THE EMERGING JOB TRAINING LEGISLATION. PERHAPS THE SECRETARY OF LABOR COULD BE AUTHORIZED TO MAKE SPECIAL JOB TRAINING GRANTS TO AREAS DESIGNATED AS ENTERPRISE ZONES, POSSIBLY ON A MATCHING BASIS WITH LOCAL GOVERNMENTS. MOST LOCAL GOVERNMENTS COULD BE GIVEN SPECIAL CONSIDERATION FOR ZONE DESIGNATION IF THEY AGREED TO INCLUDE A FUND FOR A TRAINING COMPONENT IN THEIR APPLICATION PACKAGE. THE MAIN OBJECTIVE IS TO GET DISADVANTAGED PERSONS INTO A CAREER PATH. THIS USUALLY REQUIRES BOTH JOB PREPARATION TRAINING AND LATER ON-THE-JOB TRAINING. THE GOVERNMENT FUNDS WOULD BE USED FOR PRE-EMPLOYMENT TRAINING AND THE TAX CREDIT WOULD PROVIDE NOT ONLY THE MEANS FOR ADDITIONAL TRAINING AFTER EMPLOYMENT BUT ALSO THE INCENTIVE TO PROVIDE THAT EXTRA EFFORT REQUIRED TO GET A DISADVANTAGED PERSON INTO A CAREER PATH AND NOT JUST A SHORT-TERM JOB.

CONCLUSION

IN CONCLUSION, MR. CHAIRMAN, LET ME JUST SAY THAT THE TIME IS LONG OVERDUE TO TAKE EFFECTIVE STEPS TO REBUILD OUR POVERTY-STRICKEN URBAN AND RURAL AREAS. WE KNOW HOW TO DO IT, BUT INCENTIVES ARE LACKING WHICH WILL ATTRACT THE PUBLIC/PRIVATE PARTNERSHIPS IN PLACE THAT ARE NECESSARY FOR SUCCESS.

PROPERLY STRUCTURED, ENTERPRISE ZONE LEGISLATION CAN PROVIDE THE INCENTIVES. THERE ARE ATTRACTIVE BENEFITS FOR ALL IN A PROPERLY CONCEIVED PROGRAM. THE MODEST COST TO THE GOVERNMENT WILL BE RECOVERED MANY TIMES. A LARGE NUMBER OF BADLY NEEDED JOBS WILL BE CREATED AND ATTRACTIVE PROFITS CAN BE MADE BY THOSE WHO INVEST IN THE REVITALIZATION EFFORTS. THAT REPRESENTS THE AMERICAN ENTERPRISE SYSTEM FUNCTIONING IN THE FINEST WAY.

Senator CHAFEE. Thank you very much, Mr. Norris, for that statement. Your testimony is particularly significant. As I say, you have been involved with this individually and through your company, and the points you make are very good.

You heard Senator Bradley ask Mr. Chapoton the question about the 100-percent writeoff for the original investment. Mr. Chapoton didn't show much enthusiasm for that, but it seems to me that that is the only way we are going to get the investment in there, upfront.

Mr. NORRIS. Absolutely.

We have had some experience with this. For example, in Toledo there is a lot of interest locally, but when you come right down to getting people, investors, institutions, companies to put their money there, they are very, very slow.

Senator CHAFEE. You have worked with Mayor Schaefer, have you not?

Mr. NORRIS. We certainly have, and he's a model that you should follow.

Senator CHAFEE. Well, he's here. He's next up at bat.

Mr. NORRIS. You are very fortunate.

Senator CHAFEE. He says nice things about you, too, Mr. Norris. How has it come along there, from your point of view? Has it been a Control Data investment?

Mr. NORRIS. Well, it has been City Venture, Control Data, the city of Baltimore, and the community. It is really a cooperative effort. I mentioned this magnet facility—we are in the process of locating one there in the area that is being revitalized.

Senator CHAFEE. Well, fine.

Senator Bradley?

Senator BRADLEY. Yes.

I didn't hear all of your testimony, but how important do you think the various support services that the city provides to an urban enterprise zone are? And do you put some premium on coordination of Federal programs such as EDA and UDAG to supplement whatever incentives might flow from the urban enterprize zone legislation?

Mr. NORRIS. Well, our answer to both of those questions is, very important. There should be coordination with existing programs. For example, in Baltimore, and Toledo, where we have the most successful urban revitalization projects, there has been up-front money. EDA, UDAG—UDAG has been especially important.

Senator **Bradley**. Would those investments have been made had there not been UDAG and EDA funds?

Mr. **Norris**. We could never have gotten Toledo off the ground. The mayor can speak for Baltimore, but I think it would have been pretty tough without it, even in Baltimore.

Senator **Bradley**. So, are you saying that even with the urban enterprise zone legislation there has to be additional Federal commitments to convince you to engage in more investment in urban centers?

Mr. **Norris**. Well, let me put it this way: There are so many facets to this problem that it is almost impossible to address them all simultaneously. And, of course, it is the chicken and egg. You can go ahead and invest funds in improving housing, the infrastructure, and so forth, but if you don't have jobs you won't really get very far.

On the other hand, without that improvement you can only go so far. So they must go hand in hand.

I am a practical person; I always like to take what's available. So I concentrated mostly on job creation here in addition to the present bill; because I didn't sense that there was going to be too much of an expansion of UDAG, EDA, and other programs. So today I am concentrating on job creation, but that doesn't mean that other programs are not vital.

Senator **Bradley**. But, as I think I understand your point, you are saying that you can't create jobs on top of a crumbling infrastructure.

Mr. **Norris**. Right. Not for very long.

Senator **Bradley**. And an investment would not be a wise one if it were made for the short-term job potential, if it was made on top of a crumbling infrastructure?

Mr. **Norris**. Correct.

Senator **Bradley**. What are your specific thoughts on what the Federal Government should do to insure that that infrastructure isn't crumbling?

Mr. **Norris**. Keep UDAG alive and growing. That's been a very successful program, and that coupled with enterprise zone legislation——

Senator **Bradley**. What about EDA?

Mr. **Norris**. EDA is structured somewhat differently.

Senator **Bradley**. More targeted?

Mr. **Norris**. It should be more targeted.

Senator **Bradley**. Any other programs that you think are essential? What about general revenue sharing, or targeted revenue sharing?

Mr. **Norris**. Targeted revenue sharing has a place.

Senator **Bradley**. Does it fit into your own calculations as to whether you will make an investment?

Mr. **Norris**. No.

Senator **Bradley**. It doesn't?

Mr. **Norris**. It did not, but it could be very important—properly structured.

Senator **Bradley**. Thank you very much for your participation.

Mr. **Norris**. Thank you.

Senator **Bradley**. The next witnesses will be a panel consisting of Mayor Donald Schaefer of Baltimore, Mayor Melvin Primas of Camden, N.J., and Mayor Winfield Moses of Fort Wayne, Ind.

Welcome to the committee, gentlemen.

I hope the other two mayors won't feel slighted if I offer a particular welcome to the new mayor of Camden. Melvin Primas is doing an outstanding job, and we hope to hear more of him on the national level as it relates to issues concerning the cities of this country.

The procedure here is to try to get through everyone's testimony. As a courtesy to the present chairman, I think we will lead off with Mayor Primas, unless you have a mutual agreement as to who should be first.

If not, let Mayor Primas go first.

Please keep in mind that we have a limitation. If you can summarize your statement, that would be advisable. Then we can get to the questions. If you hear a bell, that means the time is up.

STATEMENT OF HON. MELVIN R. PRIMAS, MAYOR OF CAMDEN, N.J.

Mayor **Primas**. Fine. Thank you very much, Senator.

Good morning. Mr. Chairman, I am Melvin Primas, mayor of the city of Camden, N.J.

At the outset, Mr. Chairman, please permit me to express my appreciation to you and the members of this subcommittee for the opportunity to present testimony on the Enterprise Zone Act of 1982.

I have been following the development and evolution of this legislation over the past 2 years with a great deal of interest. During this time, I have listened very carefully to both the critics and the supporters of the legislative concept. I have read a number of reports and studies both pro and con on the subject, and I have made an effort to follow the progress of the British experimental program on which the American legislative model is somewhat based.

My conclusions on the merit of the proposed program are based not only on my personal study but also upon my conviction that the chairman of this subcommittee would not have devoted nearly 2 years of his life to the development of this legislation if he were not convinced that it was going to help solve our pressing national problem of urban economic deterioration.

Mr. Chairman, I believe that the critics of the proposed urban enterprise zone program have somewhat overlooked your clearly stated position that this is an experimental program.

As you have said, the purpose is to move slowly and acquire experience before we implement a comprehensive national program of enterprise zones.

In times like these, we must be willing to try new approaches. After all, not trying is far worse than not succeeding. And I am convinced that the enterprise zone program will work—perhaps not everywhere, but certainly in a city like Camden, N.J.

Let me tell you something about my city and why I believe that the urban enterprise zone will work there.

First, Camden is a city made to order for an enterprise zone as far as public and private sector needs are concerned. At this moment, we are struggling with a city-side adult unemployment rate of 21 percent. Minority youth unemployment stands at a staggering 45 percent. Out of our total population of 85,000 persons, approximately 36,000 are CETA eligible. In other words, over 41 percent of our total population are poor and jobless.

The outmigration of business and industry over the last 20 years has severely eroded our local tax base. In order to maintain vital city services, property taxes for the remaining residents and businesses have been steadily increased over that same period. As you well know, Mr. Chairman, this vicious cycle creates an environment that is hardly conducive to new business investment.

At the same time, and in the midst of this economic dilemma, we can clearly see that Camden has a lot of positive attributes that should and could attract new investment and create jobs, given the right set of business incentives.

Since the city of Camden is located right next to Philadelphia, businesses locating in our city would have easy access to the substantial Metropolitan Philadelphia market. Camden also enjoys superior road transportation access to the Metropolitan New York market.

We have a large pool of unemployed skilled workers who are eager for the chance to get back on the job. We also have an effective job training program that works in close cooperation with the private industry council and the local business community to get our less skilled unemployed job ready.

We have already established close ties with neighboring colleges and universities, which cooperate with the local business community to promote technological innovation and improved business management.

We have skilled professionals in our city government who work in close cooperation with the local business community to take full advantage of financial assistance and tax relief programs offered by the State and Federal Government for the purpose of promoting local economic development.

And, perhaps most important, we have a city government that is responsive to the local business community and which works on a team approach with the private sector to promote local economic development activity.

We are now ready to take the next step—to tie these local resources and capacities to a specially designed set of Federal tax incentives and to focus these combined incentives in an urban enterprise zone.

It has long been my contention that if a program will work in Camden, it will work anywhere—primarily because Camden is a microcosm of our national urban dilemma. I intend to work in close cooperation with Governor Kean and members of the Camden business community to develop a competitive proposal for consideration by the Department of Housing and Urban Development. If Camden receives an enterprise zone designation, I intend to spare no effort to insure the success of our local zone program

And, notwithstanding the experimental nature of this program, I believe that the Chairman and members of this subcommittee are similarly committed to taking all practicable steps toward insuring a successful outcome for this program.

Toward this objective, it is my sincere hope that the subcommittee will give serious consideration to some recommendations and observations that I have regarding the urban enterprise zone legislation.

Since the legislation has been described by many of its cosponsors and proponents as being specifically designed to assist small businesses, I believe we should take cognizance of those problems that small businesses perceive as being most critical to their survival.

A comprehensive survey conducted in November of 1981 by the National Federation of Independent Businesses revealed that interest rates were the No. 1 problem of urban small businesses, out of a total problem universe of 25. Local tax rates were the fifth ranking problem identified by the NFIB respondents. This is an important issue, given the emphasis placed in the legislation on State and local government tax abatement as a criteria for designation as an enterprise zone.

Also important is the NFIB finding that local inspections and inspectors, and the ease in getting licenses and permits, were ranked as the 21st and 22d most important business problems out of a total of 25 problems identified. Again, this is a very significant finding, given the fact that the criteria for designation as an urban enterprise zone includes removing or reducing requirements relative to inspections, licenses, and permits at the local level.

Looking at the total list of problems identified by the NFIB respondents, one concludes that the proposed urban enterprise zone legislation would impact directly or indirectly on 9 of the 25 problem areas. In purely numerical terms, that sounds pretty good. However, objectivity demands that one examine the relative rank of those problems to determine how much of a beneficial impact the legislation would have for the NFIB small business respondents. The result of that examination is that even with the legislation in place, small businesses would still be facing some pretty severe money problems.

A possible solution would be to restore the refundable tax credits that were a feature in the original version of Senator Boschwitz' bill, S. 1310.

The restoration of refundable tax credits would provide sorely needed capital to new and smaller existing business firms which do not generate enough profit to make a nonrefundable tax credit worthwhile. Furthermore, restoration of the refundable tax credits on employee wages will respond to the needs of more labor-intensive small businesses.

I would also urge the subcommittee to strongly consider restoring the language contained in the original Boschwitz bill, which would have provided special incentives for venture capital loans to new firms. Both of these recommended restorations would respond directly to the capital needs of both new and existing small businesses.

Another area of the legislation that deserves the consideration of the subcommittee is the section concerning zone selection and designation criteria. Although the legislation does provide that the

Secretary shall consider the relative fiscal condition of the applicant community and its ability to offer tax abatements, that consideration appears to have a much lesser weight than the strength and quality of contributions proposed to be made by the applicant.

I would hope that the subcommittee would expressly declare its intention that the relative fiscal condition of the State and local governments, and the relative ability of such governments to offer tax abatements will be given a priority consideration by the Department of Housing and Urban Development in assessing zone designation applications.

One final area in the designation criteria section causes me grave concern. That section would require the Secretary to give preference to, and I quote, "those nominated zones which best exhibit such other factors to be determined by the Secretary of Housing and Urban Development, as are: (a) consistent with the intent of the enterprise zone program; and (b) important to minimizing the unnecessary loss of tax revenues to the Federal Government."

In its policy document issued in March, the administration indicated that, and again I quote, "the Secretary will have the discretionary power to deny a zone application based on one of these elements alone."

In view of the critical importance of these unidentified factors to all prospective applicants, I would hope that the subcommittee would insert language requiring the Secretary to fully identify all selection and designation and selection criteria and factors, and to publish such criteria and factors in the Federal Register for public review and comment, and to submit such criteria and selection factors to the appropriate committees of the Congress for review and approval.

Mr. Chairman, I hope that the subcommittee will also consider the insertion of language in the legislation to insure that any State or local deregulation would be subject to the same limitations as are imposed upon the Federal Government; that is, that regulatory relief shall not affect public health or safety, civil rights protections, or the minimum wage for zone workers. This would insure that all applicant communities maintain certain basic and fundamental standards, and that neither workers nor residents are exposed to unacceptable risks as a tradeoff for economic development.

Senator **Bradley**. Mr. Primas, the bell went off.

Mayor **Primas**. I'm sorry. I delayed hearing it.

Senator **Bradley**. Could we go on to the next witness?

Mayor **Primas**. Absolutely.

Senator **Bradley**. I read your conclusion, and I will convey your sentiments of congratulation to the chairman.

Mayor **Primas**. Great.

Senator **Bradley**. Thank you.

Mayor **Primas**. Thank you.

STATEMENT OF HON. DONALD SCHAEFER, MAYOR OF THE CITY OF BALTIMORE

Mayor **Schaefer**. Thank you very much, Mr. Chairman.

Before I start on my time, if I might just take a minute——

Senator **Bradley**. This is the experienced witness. [Laughter.]

Mayor **Schaefer**. No, I'm an elected official, too, as all of us are. What we hear mostly is criticism and someone saying that we want more and more. Every once in a while we forget to thank the Federal Government for the things they have done for us, and I would like to, on behalf of the people of the city of Baltimore and myself. Because of the commitments from the Federal Government, the city has been able to move. Sometimes you don't hear that. So I want to let you know that if you come to Baltimore you will see some of the programs.

Second, you have heard from one of the truly great men in industry, a Mr. Norris. Mr. Norris not only comes over and testifies about things that he would like to see done, he does things. It is a man committed to jobs. If it wasn't for Mr. Norris, the enterprise zone which we have, which really isn't an enterprise zone, we wouldn't have that. It was his commitment to that community and his belief in jobs that allowed us to do it. I just want personally to commend him. You put it exactly right—he puts his money where his mouth is, and he produces. He is a great man.

We worked with Mr. Garcia and Mr. Kemp for over a year on enterprise zones. We are very pleased that the members of the committee and the President, and others, have come forth with the enterprise zone legislation.

Now, when you are at my level of government, you are interested in jobs, j-o-b-s, reducing unemployment, and stimulating the economy and economic development. In my mind it is important to target economic resources and programs to areas of greatest need, and that is to areas of high unemployment. I think every mayor in a city like ours, the three mayors that are here, I could quote statistics of 54 percent unemployed minorities in certain areas of the city, high unemployment; but I think you have heard all of that, so I won't go into it.

The timing of the administration proposal for an enterprise zone couldn't be better, because of high unemployment. Unemployment has risen to a breaking point, business investments are low and down, loans and guaranteed programs are difficult to obtain, and the labor pool is increasingly mismatched with existing jobs. We need an inducement by the President and the Congress to solve urban problems. I am all for solving other problems, but there are direct problems in cities that must be addressed, and in my mind this is the first emphasis on solving the problem of an urban area.

I am pleased that Senator Chafee and others have been able to move the legislation along, and we are very pleased that we were able to get our State to have an enterprise zone legislation. I don't think you can have an enterprise zone legislation for every State that is exactly the same. All States are different. What we had in ours was a tax incentive for capital investment, access to capital for physical improvements, incentives for hiring unemployed workers, loan guarantees, recognition of need for public infrastructure and targeting.

I read the newspaper on those who are opposed to enterprise zones. I think it is very easy to be against something, and it's very difficult to be for something, I guess. So I would like to say to those who oppose it, this is an experimental program and we need some innovative ideas, new ideas, new approaches. We, on the level of directly working with people where the people are unemployed, favor this type of legislation. We are very pleased that we have it.

Now, if you will allow me a little latitude, I would like to use a few boards. [Showing of charts.]

First, we would like to say what we think an urban economic development should be—a formula.

First, it must be a city commitment, a commitment by the mayor. We have it.

A State commitment, by the Governor. We did that by getting the Governor to pass legislation.

Private sector commitment by Mr. Norris. That is already there. That is very important.

An area with a good potential for success.

A concentration on one word, again, "jobs."

A commitment by the Federal Government, which is the enterprise zone. And that is important.

And then, you have what is known as fccusing for the survival of the Nation's cities.

Now, what is good about the enterprise zone?

One, new tools for economic development in distressed areas to make the distressed areas more competitive. I have heard testimony today about "Maybe people don't want to work there; maybe they want to work out in areas where there is a lot of greenery around," and so forth. We want to make these areas more competitive in what we call "lost communities."

Two, we must target to areas of greatest need, and that's an important word "targeting to areas of greatest need."

Three, new possibilities for public and private partnerships.

Four, new jobs for the unemployed.

Five, new capital investments in the rundown neighborhoods.

Six, new hope and improved quality of life for the people.

The time is now. We have a little propaganda on the bottom, but we are ready for an enterprise zone.

I don't know if we are going to get it or not, but with Mr. Norris' help, whether we get it or not, we are going to move forward with our concept of our enterprise zones. We are not sure we are going to get one. [Change of charts.]

Now, to make an enterprise zone work, we think there ought to be two added things—two things that are very important from our standpoint.

One. Job training for enterprise zone employees. You can't expect the employers to take untrained people. They have got to have the job training. We have one of the best manpower programs in the United States, I think. We can prove that when you have a good program you can train people, put them in industry, and they would work productively. We think this training segment is absolutely essential if the enterprise zone is to work: try-out employment, on-the-job training, skill training, attitude training.

Now, you say, "What is attitude training?" Some people have never had a job. It is very difficult for people to understand that some people have never worked, and they have to learn to get there at 8:30 in the morning, leave at 4:30 in the afternoon, work every day, work on Saturdays and Sundays and Fridays, if it is absolutely necessary. So attitude training is important.

Two. The second thing, venture capital, is essential for new business startups. Wherever we went, all over the United States, we heard from small business that they do need some venture capital essential for start-up. They lose chances for new business survival, because the first 4 or 5 years is the difficult time.

New small business is the best source of new jobs. As you heard the Governor say, and everyone else, the small business is where the jobs are at the present time. [Change of charts.]

Now, to make the enterprise zone work even better, what we would like, of course, is infrastructure investments. The areas you are talking about are older areas, the depressed areas, areas that are not attractive. They must have streets, lights, water, sewer, security—all those things. We can do part of it, but we need some assistance from the Federal Government, if we can get it.

The question is "If we don't get it are we just going to say no?" The answer is "No; because if you believe in an enterprise zone, you will divert some of your resources there. But you are taking it away from another area, because there is only so much money."

A refundable tax credit to keep small business going and growing.

And targeted Federal tools. This is a very important one that you just talked about with Mr. Norris.

UDAG targeted to enterprise zones.

Small business loans targeted to the enterprise zones.

The IRB targeted to the enterprise zones.

Defense contracts, all the things, targeted toward the zones to make sure they survive.

The last one, of course, is the EDA infrastructure that we need. [Change of charts].

Pilot enterprise zone. Why? It meets all of the criteria.

We are just going to very briefly—it will only take me a minute—tell you why Clark Heights, what Mr. Norris has given, is an area. It meets all the criteria, has a head start, a city venture, a plan for 2,500 jobs that Mr. Norris is going to put up in the area, Control Data. Business and technology in the center, groundbreaking, all before 1981. It has already started this. Commercial Credit and a new bindery that he has put up in there; business and community support involving a track record on making things work. We think we can do that.

[Change of charts.]

The last thing, an enterprise zone right here, away from all the other industrial areas, right close to a low income area, would have a training force if they were trained.

Where we spent a tremendous amount of money in doing the things you have talked about—improving housing conditions, and all the rest, one of the important things that you and the Senators talked about, taking the jobs, taking the opportunities to where the people are rather than having these people travel all over the place in all the areas, moving it right into an area, exactly where the people are. That is very important.

Now, let me tell you about whether we are going to do it or not. Again, 1 second. If I talk too long, you can tell me to stop.

We are going to have an enterprise zone whether we get a Federal designation or not. We are going to have an enterprise zone whether we get the State designation or not. Because we have a commitment by Mr. Norris; we have a commitment that we are going to make it work. It has every bit of the criteria.

We would like to have one, if you would give us one. But if you don't, we've got the commitment there, and it's going to work.

Finished. [Laughter.]

Senator **Bradley**. Thank you very much, Mayor Schaefer. Quite impressive.

Let's go on to Mayor Moses, and then we will get to questions.

STATEMENT OF HON. WINFIELD MOSES, MAYOR OF FORT WAYNE, IND., FOR THE U.S. CONFERENCE OF MAYORS

Mayor Moses. Thank you, Senator Bradley.

It looks like perhaps my job is to see if I can end when the bell does and show that perhaps mayors can do that.

We want to very much thank the committee and yourself for allowing the Conference of Mayors to make a statement on behalf of many interests. We are certainly very supportive of this concept and have been for a number of years. As you are probably aware, we testified 10 months ago in favor of the concept in essence.

As a mayor of a midsize city, and speaking on behalf of the conference, I would like to buttress what the two mayors beside me have essentially said; and that is "Yes, there are very good concepts here, but we want to be certain that some of the problems that we on the frontline face are addressed in this."

As Mayor Primas pointed out, one of those certainly is to be sure that there is assistance for new businesses. And as Mayor Schaefer pointed out, clearly a reduction in taxes or the elimination of taxes is not singularly enough to entice a new business to move into this area.

And I think we want to be certain that we are not basically moving businesses across the street or putting geographically low created business that are close to these enterprise areas at a disadvantage in any instance.

Finally, I think we all realize that the basic detriment to business at this time is the high cost of capital and the difficulty of securing capital. So, anything we can do with this concept to assist with that, a new venture fund or a refundable tax credit, as others have brought up, is an important concept.

Likewise, it is important that these enterprise zones be linked with a number of other Federal programs. You have made a point of asking very astute questions in that regard, and it is clear that these are not independent entities that exist without any other linkage to the balance of Federal programs, State, or local programs.

It is particularly nice to see the Secretary of Commerce here to explain and emphasize the need for foreign trade zones. I think that will be quite helpful in some cities, and a number of mayors have expressed a great deal of interest in that. That is fortunate.

We want to be very careful, though, as we go through this process, that we don't look at this program to the exclusion of our training programs, as Mayor Schaefer pointed out, to our economic and development programs and housing programs which are so important for those people who live in those areas, to our educational programs, which are the only way we can bring people forward in this world, and certainly to our industrial revenue bonds—that cannot be overlooked—and finally, to an urban amenity called parks, which are important. People may not think of that as necessary in these days. It is, in fact, necessary. We can't completely do away with the nature of an urban entity such as cities.

And our UDAG's and EPA wastewater programs, and public transportation activities, cannot cease. These programs will not work without some measure of those being involved. We want to be certain, as the mayors, that this program is not seen or viewed as a substitute for ongoing Federal programs. Secretary Pierce assured us of that this morning, but often this seems to gain much more notoriety than the balance, and it clearly is not meant as a substitute in any fashion. I think we all appreciate that and need to keep that closely in front of us.

It is also important that mayors throughout this nation be given the opportunity to develop their own agendas in their communities to deal with urban enterprise areas, that we not be so rigidly locked in by the Federal Government or the State that we are required to do things that we know in our hearts will not work in these communities, whether they be zoning changes or occupational licensing or contracting out of services to the private sector. I think it is important that the Federal Government not feel, for instance, that they can require a city in Indiana to privately contract for its garbage, for instance, or for some other entity. Because we deal with the realities of our economics and our politics at the front level, we wrestle with those bears every day, we are held accountable to do what is most prudent, and that usually means the lowest and best costs. I would hope that that is not too rigidly created by the Federal Government when they begin this process.

We certainly would hope, too, that there is some ameliorization of the State's ability, in essence, to veto an enterprise zone. I don't think that that's a problem in most areas; I don't think that it's a problem in the State of Indiana; but a number of States are quite concerned, and mayors are concerned that there should be some leeway in this, that cities which, again, are where these are going to be located and will basically be run from should be allowed to have more leeway than they presently have under the law as it is created here.

Finally, it is important that we emphasize, here, jobs. Mayor Schaefer said that very clearly and very well, that this is not meant solely as an investment opportunity for warehousing, that it is not meant as an entity only to increase tax safe-harbor provisions or analogous situations; it is in fact designed to create jobs. Where this is a warehousing operation that doesn't, or it's a pass-through of some nature, that's perhaps inappropriate to the concept. There should be an investment in employment here as well as an investment in the financial considerations. And I hope that the bill will directly address that problem.

Finally, we made a strong point of this being an experimental program and that we should consider it in that fashion. I think, also, we have to be aware that when we limit it to a 3-year time period or a package of small magnitude, in that sense, that we inhibit the ability of an investor to come in and make long-range plans. I say that as much as a third-generation homebuilder, which I am, as a mayor. And I think it is important that we try to give some long-range security to a company that is going to make a substantial investment, from their perspective, in this concept. And I know that is what we want to do in the long run.

To end, here, again I would like, speaking on behalf of the Conference of Mayors, to thank you very much for the opportunity not only to speak but to discuss a serious concern for our community and for our Nation that has to be addressed. We appreciate that opportunity a great deal.

Senator **Bradley**. Thank you very much for your testimony.

[The statements of the previous panel follow:]

TESTIMONY OF
THE HONORABLE MELVIN R. PRIMAS, JR.
MAYOR OF THE CITY OF CAMDEN, NEW JERSEY

GOOD MORNING, MR. CHAIRMAN. I AM MELVIN PRIMAS, MAYOR OF THE CITY OF CAMDEN, NEW JERSEY.

AT THE OUTSET, MR. CHAIRMAN, PLEASE PERMIT ME TO EXPRESS MY APPRECIATION TO YOU AND THE MEMBERS OF THIS SUBCOMMITTEE FOR THE OPPORTUNITY TO PRESENT TESTIMONY ON THE ENTERPRISE ZONE TAX ACT OF 1982.

I HAVE BEEN FOLLOWING THE DEVELOPMENT AND EVOLUTION OF THIS LEGISLATION OVER THE PAST TWO YEARS WITH A GREAT DEAL OF INTEREST. DURING THIS TIME, I HAVE LISTENED VERY CAREFULLY TO BOTH THE CRITICS AND THE SUPPORTERS OF THE LEGISLATIVE CONCEPT. I HAVE READ A NUMBER OF REPORTS AND STUDIES -- BOTH PRO AND CON -- ON THE SUBJECT. AND, I HAVE MADE AN EFFORT TO FOLLOW THE PROGRESS OF THE BRITISH EXPERIMENTAL PROGRAM ON WHICH THIS AMERICAN LEGISLATIVE MODEL IS SOMEWHAT BASED.

MY CONCLUSIONS ON THE MERIT OF THE PROPOSED PROGRAM ARE BASED NOT ONLY ON MY PERSONAL STUDY, BUT ALSO UPON MY CONVICTION THAT THE CHAIRMAN OF THIS SUBCOMMITTEE WOULD NOT HAVE DEVOTED NEARLY TWO YEARS OF HIS LIFE TO THE DEVELOPMENT OF THIS LEGISLATION IF HE WERE NOT CONVINCED THAT IT WAS GOING TO HELP TO SOLVE OUR PRESSING NATIONAL PROBLEM OF URBAN ECONOMIC DETERIORATION.

MR. CHAIRMAN, I BELIEVE THAT THE CRITICS OF THE PROPOSED URBAN ENTERPRISE ZONE PROGRAM HAVE SOMEHOW OVERLOOKED YOUR CLEARLY-STATED POSITION THAT THIS IS AN EXPERIMENTAL PROGRAM.

AS YOU HAVE SAID, THE PURPOSE IS TO MOVE SLOWLY AND ACQUIRE EXPERIENCE BEFORE WE IMPLEMENT A COMPREHENSIVE NATIONAL PROGRAM OF ENTERPRISE ZONES.

IN TIMES LIKE THESE, WE MUST BE WILLING TO TRY NEW APPROACHES, AFTER ALL, NOT TRYING IS FAR WORSE THAN NOT SUCCEEDING.

AND, I AM CONVINCED THAT THE ENTERPRISE ZONE PROGRAM WILL WORK... PERHAPS NOT EVERYWHERE, BUT CERTAINLY IN A CITY LIKE CAMDEN, NEW JERSE

LET ME TELL YOU SOMETHING ABOUT MY CITY, AND WHY I BELIEVE THAT AN URBAN ENTERPRISE ZONE WILL WORK THERE.

FIRST, CAMDEN IS A CITY MADE-TO-ORDER FOR AN ENTERPRISE ZONE AS FAR AS PUBLIC AND PRIVATE SECTOR NEEDS ARE CONCERNED.

AT THIS MOMENT, WE ARE STRUGGLING WITH A CITY-WIDE, ADULT UNEMPLOYMENT RATE OF 21%. MINORITY YOUTH UNEMPLOYMENT STANDS AT A STAGGERING 45%.

OUT OF OUR TOTAL POPULATION OF 87,500 PERSONS, APPROXIMATELY 36,000 ARE CETA-ELIGIBLE. IN OTHER WORDS, OVER 41% OF OUR TOTAL POPULATION ARE POOR AND JOBLESS.

THE OUTMIGRATION OF BUSINESS AND INDUSTRY OVER THE LAST TWENTY YEARS HAS SEVERELY ERODED OUR LOCAL TAX BASE. IN ORDER TO MAINTAIN VITAL CITY SERVICES, PROPERTY TAXES FOR REMAINING RESIDENTS AND BUSINESSES HAVE BEEN STEADILY INCREASED OVER THE SAME PERIOD. AS YOU WELL KNOW, MR. CHAIRMAN, THIS VICIOUS CYCLE CREATES AN ENVIRONMENT THAT IS HARDLY CONDUCIVE TO NEW BUSINESS INVESTMENT.

AT THE SAME TIME, AND IN THE MIDST OF THIS ECONOMIC DILEMMA, WE CAN CLEARLY SEE THAT CAMDEN HAS A LOT OF POSITIVE ATTRIBUTES THAT SHOULD AND COULD ATTRACT NEW INVESTMENT AND CREATE JOBS -- GIVEN THE RIGHT SET OF BUSINESS INCENTIVES.

SINCE THE CITY OF CAMDEN IS LOCATED RIGHT NEXT TO PHILADELPHIA, BUSINESSES LOCATING IN OUR CITY WOULD HAVE EASY ACCESS TO THE SUBSTANTIAL METROPOLITAN PHILADELPHIA MARKET. CAMDEN ALSO ENJOYS SUPERIOR ROAD TRANSPORTATION ACCESS TO THE METROPOLITAN NEW YORK MARKET.

WE HAVE A LARGE POOL OF UNEMPLOYED SKILLED WORKERS WHO ARE EAGER FOR THE CHANCE TO GET BACK ON THE JOB. WE ALSO HAVE AN EFFECTIVE JOB TRAINING PROGRAM THAT WORKS IN CLOSE COOPERATION WITH THE PRIVATE INDUSTRY COUNCIL AND THE LOCAL BUSINESS COMMUNITY TO BET OUR LESS-SKILLED UNEMPLOYED JOB-READY.

WE HAVE ALREADY ESTABLISHED CLOSE TIES WITH NEIGHBORING COLLEGES AND UNIVERSITIES, WHICH COOPERATE WITH THE LOCAL BUSINESS COMMUNITY TO PROMOTE TECHNOLOGICAL INNOVATION AND IMPROVED BUSINESS MANAGEMENT.

WE HAVE SKILLED PROFESSIONALS IN OUR CITY GOVERNMENT WHO WORK IN CLOSE COOPERATION WITH THE LOCAL BUSINESS COMMUNITY TO TAKE FULL ADVANTAGE OF FINANCIAL ASSISTANCE AND TAX RELIEF PROGRAMS OFFERED BY THE STATE AND FEDERAL GOVERNMENTS FOR THE PURPOSE OF PROMOTING LOCAL ECONOMIC DEVELOPMENT.

AND, PERHAPS MOST IMPORTANT, WE HAVE A CITY GOVERNMENT THAT IS RESPONSIVE TO THE LOCAL BUSINESS COMMUNITY AND WHICH WORKS ON A TEAM APPROACH WITH THE PRIVATE SECTOR TO PROMOTE LOCAL ECONOMIC DEVELOPMENT ACTIVITY.

WE ARE NOW READY TO TAKE THE NEXT STEP -- TO TIE THESE LOCAL RESOURCES AND CAPACITIES TO A SPECIALLY-DESIGNED SET OF FEDERAL TAX INCENTIVES AND TO FOCUS THESE COMBINED INCENTIVES IN AN URBAN ENTERPRISE ZONE.

IT HAS LONG BEEN MY CONTENTION THAT IF A PROGRAM WILL WORK IN CAMDEN, IT WILL WORK ANYWHERE -- PRIMARILY BECAUSE CAMDEN IS A MICROCOSM OF OUR NATIONAL URBAN DILEMMA. I INTEND TO WORK IN CLOSE COOPERATION WITH GOVERNOR KEAN AND WITH THE MEMBERS OF CAMDEN'S BUSINESS COMMUNITY TO DEVELOP A COMPETITIVE PROPOSAL

FOR CONSIDERATION BY THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT. IF CAMDEN RECEIVES AN ENTERPRISE ZONE DESIGNATION, I INTEND TO SPARE NO EFFORT TO ENSURE THE SUCCESS OF OUR LOCAL ZONE PROGRAM.

AND, NOTWITHSTANDING THE EXPERIMENTAL NATURE OF THIS PROGRAM, I BELIEVE THAT THE CHAIRMAN AND MEMBERS OF THIS SUBCOMMITTEE ARE SIMILARLY COMMITTED TO TAKING ALL PRACTICABLE STEPS TOWARD ENSURING A SUCCESSFUL OUTCOME FOR THIS PROGRAM.

TOWARD THIS OBJECTIVE, IT IS MY SINCERE HOPE THAT THE SUBCOMMITTEE WILL GIVE SERIOUS CONSIDERATION TO SOME RECOMMENDATIONS AND OBSERVATIONS THAT I HAVE REGARDING THE URBAN ENTERPRISE ZONE LEGISLATION.

SINCE THE LEGISLATION HAS BEEN DESCRIBED BY MANY OF ITS CO-SPONSORS AND PROPONENTS AS BEING SPECIFICALLY DESIGNED TO ASSIST SMALL BUSINESSES, I BELIEVE WE SHOULD TAKE COGNIZANCE OF THOSE PROBLEMS THAT SMALL BUSINESSES PERCEIVE AS BEING MOST CRITICAL TO THEIR SURVIVAL.

A COMPREHENSIVE SURVEY CONDUCTED IN NOVEMBER OF 1981 BY THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS REVEALED THAT INTEREST RATES WERE THE NUMBER ONE PROBLEM OF URBAN SMALL BUSINESSES, OUT OF A TOTAL PROBLEM UNIVERSE OF TWENTY-FIVE. LOCAL TAX RATES WERE FIFTH-RANKING PROBLEM IDENTIFIED BY NFIB RESPONDENTS. THIS IS AN IMPORTANT ISSUE, GIVEN THE EMPHASIS PLACED IN THE LEGISLATION ON STATE AND LOCAL GOVERNMENT TAX ABATEMENT AS A CRITERIA FOR DESIGNATION AS AN ENTERPRISE ZONE.

ALSO IMPORTANT IS THE NFIB FINDING THAT LOCAL INSPECTIONS AND INSPECTORS, AND EASE IN GETTING LICENSES AND PERMITS, WERE RANKED AS THE 21ST AND 22ND MOST IMPORTANT BUSINESS PROBLEMS OUT OF A TOTAL OF TWENTY-FIVE PROBLEMS IDENTIFIED. AGAIN, THIS IS

A VERY SIGNIFICANT FINDING, GIVEN THE FACT THAT THE CRITERIA FOR DESIGNATION AS AN URBAN ENTERPRISE ZONE INCLUDES REMOVING OR REDUCING REQUIREMENTS RELATIVE TO INSPECTIONS, LICENSES AND PERMITS AT THE LOCAL LEVEL.

LOOKING AT THE TOTAL LIST OF PROBLEMS IDENTIFIED BY NFIB RESPONDENTS, ONE CONCLUDES THAT THE PROPOSED URBAN ENTERPRISE ZONE LEGISLATION WOULD IMPACT DIRECTLY OR INDIRECTLY ON 9 OF THE 25. IN PURELY NUMERICAL TERMS, THAT SOUNDS PRETTY GOOD. HOWEVER, OBJECTIVITY DEMANDS THAT ONE EXAMINE THE RELATIVE RANK OF THOSE PROBLEMS TO DETERMINE NOW MUCH OF A BENEFICIAL IMPACT THE LEGISLATION WOULD HAVE FOR THE NFIB SMALL BUSINESS RESPONDENTS. THE RESULT OF THAT EXAMINATION IS THAT EVEN WITH THE LEGISLATION IN PLACE, SMALL BUSINESSES WOULD STILL BE FACING SOME PRETTY SEVERE MONEY PROBLEMS.

A POSSIBLE SOLUTION WOULD BE TO RESTORE THE REFUNDABLE TAX CREDITS THAT WERE A FEATURE IN THE ORIGINAL VERSION OF SENATOR BOSCHWITZ'S BILL, S. 1310.

THE RESTORATION OF REFUNDABLE TAX CREDITS WOULD PROVIDE SORELY-NEEDED CAPITAL TO NEW AND SMALLER EXISTING BUSINESS FIRMS WHICH DO NOT GENERATE ENOUGH OF A PROFIT TO MAKE A NON-REFUNDABLE TAX CREDIT WORTHWHILE. FURTHERMORE, RESTORATION OF THE REFUNDABLE TAX CREDITS ON EMPLOYEE WAGES WOULD RESPOND TO THE NEEDS OF MORE LABOR-INTENSIVE SMALL BUSINESSES.

I WOULD ALSO URGE THE SUBCOMMITTEE TO STRONGLY CONSIDER RESTORING THE LANGUAGE CONTAINED IN THE ORIGINAL BOSCHWITZ BILL WHICH WOULD HAVE PROVIDED SPECIAL INCENTIVES FOR VENTURE CAPITAL LOANS TO NEW FIRMS.

BOTH OF THESE RECOMMENDED RESTORATIONS WOULD RESPOND DIRECTLY TO THE CAPITAL NEEDS OF BOTH NEW AND EXISTING SMALL BUSINESSES.

ANOTHER AREA OF THE LEGISLATION THAT DESERVES THE CONSIDERATION OF THE SUBCOMMITTEE IS THE SECTION CONCERNING ZONE SELECTION AND DESIGNATION CRITERIA. ALTHOUGH THE LEGISLATION DOES PROVIDE THAT THE SECRETARY SHALL CONSIDER THE RELATIVE FISCAL CONDITION OF THE APPLICANT COMMUNITY AND ITS ABILITY TO OFFER TAX ABATEMENTS, THAT CONSIDERATION APPEARS TO HAVE A MUCH LESSER WEIGHT THAN THE STRENGTH AND QUALITY OF "CONTRIBUTIONS" PROPOSED TO BE MADE BY THE APPLICANT.

I WOULD HOPE THAT THE SUBCOMMITTEE WILL EXPRESSLY DECLARE ITS INTENTION THAT RELATIVE FISCAL CONDITION OF THE STATE AND LOCAL GOVERNMENT AND THE RELATIVE ABILITY OF SUCH GOVERNMENTS TO OFFER TAX ABATEMENTS WILL BE GIVEN A PRIORITY CONSIDERATION BY THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT IN ASSESSING ZONE DESIGNATION APPLICATIONS.

ONE FINAL AREA IN THE DESIGNATION CRITERIA SECTION CAUSES ME VERY GRAVE CONCERN. THAT SECTION WOULD REQUIRE THE SECRETARY TO GIVE PREFERENCE TO "... THOSE NOMINATED ZONES WHICH BEST EXHIBIT SUCH OTHER FACTORS TO BE DETERMINED BY THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT, AS ARE:

(A) CONSISTENT WITH THE INTENT OF THE ENTERPRISE ZONE PROGRAM: AND

(B) IMPORTANT TO MINIMIZING THE UNNECESSARY LOSS OF TAX REVENUES TO THE FEDERAL GOVERNMENT."

IN ITS POLICY DOCUMENT ISSUED IN MARCH, THE ADMINISTRATION INDICATED THAT "...THE SECRETARY WILL HAVE THE DISCRETIONARY POWER TO DENY A ZONE APPLICATION BASED ON ONE OF THESE ELEMENTS ALONE...". IN VIEW OF THE CRITICAL IMPORTANCE OF THESE UNIDENTIFIED "FACTORS" TO ALL PROSPECTIVE APPLICANTS, I WOULD HOPE THAT THE SUBCOMMITTEE WILL INSERT LANGUAGE REQUIRING THE SECRETARY TO FULLY IDENTIFY ALL SELECTION AND DESIGNATION CRITERIA AND FACTORS, TO PUBLISH SUCH CRITERIA AND FACTORS IN THE FEDERAL REGISTER FOR PUBLIC REVIEW AND COMMENT, AND TO SUBMIT SUCH CRITERIA AND SELECTION FACTORS TO THE APPROPRIATE COMMITTEES OF THE CONGRESS FOR REVIEW AND APPROVAL.

MR. CHAIRMAN, I HOPE THAT THE SUBCOMMITTEE WILL ALSO CONSIDER THE INSERTION OF LANGUAGE IN THE LEGISLATION TO ENSURE THAT ANY STATE OR LOCAL DEREGULATION WOULD BE SUBJECT TO THE SAME LIMITATIONS AS ARE IMPOSED UPON THE FEDERAL GOVERNMENT -- THAT IS, THAT REGULATORY RELIEF SHALL NOT AFFECT PUBLIC HEALTH OR SAFETY, CIVIL RIGHTS PROTECTIONS OR THE MINIMUM WAGE FOR ZONE WORKERS. THIS WOULD ENSURE THAT ALL APPLICANT COMMUNITIES MAINTAIN CERTAIN BASIC AND FUNDAMENTAL STANDARDS, AND THAT NEITHER WORKERS NOR RESIDENTS ARE EXPOSED TO UNACCEPTABLE RISKS AS A TRADE-OFF FOR ECONOMIC DEVELOPMENT.

MR. CHAIRMAN, PERMIT ME TO CONCLUDE MY REMARKS BY ONCE AGAIN COMMENDING YOU AND THE MEMBERS OF THIS SUBCOMMITTEE FOR THE TIME AND EFFORT YOU HAVE DEDICATED TO THIS LEGISLATION. ON BEHALF OF THE CITY OF CAMDEN, I HOPE THAT THESE EFFORTS WILL CONTINUE, PARTICULARLY WITH REGARD TO THE SUCCESSFUL COORDINATION OF THE URBAN ENTERPRISE ZONE PROGRAM WITH OTHER ECONOMIC DEVELOPMENT PROGRAMS SUCH AS THE URBAN DEVELOPMENT ACTION GRANT PROGRAM, COMMUNITY DEVELOPMENT PROGRAM, AND THE RANGE OF ASSISTANCE PROGRAMS ADMINISTERED BY THE ECONOMIC DEVELOPMENT ADMINISTRATION OF THE DEPARTMENT OF COMMERCE. TOGETHER, I BELIEVE THESE PROGRAMS CONSTITUTE A FORMULA FOR SUCCESS THAT WILL REFLECT CREDIT UPON THE CHAIRMAN, THE MEMBERS OF THE SUBCOMMITTEE, AND ALL THOSE WHO HAVE WORKED ON THE LEGISLATION.

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TESTIMONY OF

THE HONORABLE WINFIELD MOSES
MAYOR, FORT WAYNE
CHAIRMAN, SUBCOMMITTEE ON FEDERAL TAX POLICY
URBAN ECONOMIC POLICY COMMITTEE

Mr. Chairman, Members of the Finance Committee, thank you for this opportunity for the U.S. Conference of Mayors to testify on enterprise zones, a subject of considerable interest to Mayors around the country.

First, let me commend you, Senator Chafee, and your colleague, Senator Boschwitz, for your leadership in sponsoring enterprise zone legislation. The U.S. Conference of Mayors has long been supportive of the concept which underlies enterprise zone legislation, namely the use of tax incentives to encourage investment and job creation in distressed urban areas. At a policy meeting last year, the Conference of Mayors adopted a comprehensive resolution on tax policy which urged the enactment of enterprise zone legislation with the following characteristics:

- flexibility with respect to the designation of zones and the commitment of resources to the zone by local governments;
- rough equality between investment and employment tax incentives;
- equal treatment for small business and special help for new ventures; and
- development of linkages between enterprise zones and other economic development and training activities.

As you know, there was much about the second version of the Kemp-Garcia-Chafee-Boschwitz bill (S.1310) which Mayors liked and supported. We testified before your Committee in general support of that bill only ten moths ago. However, we have several concerns about the Administration bill, (S.2298), which has substantially amended the earlier concept.

First, the Administration provides no special assistance or support for new businesses. In fact, their approach drops the tax incentive, encouraging banks and other investors to make loans to businesses in enterprise zones, a provision included in the Kemp-Garcia bill and which the Conference of Mayors supported. In a time of high interest rates, one of the most significant impediments to the startup of new businesses is the lack of access to the private capital markets. Thus, we have urged that the Administration and the Congress establish a "new venture fund" for small businesses in an enterprise zone, as has been done by some of the states which have enacted enterprise zone legislation. Moreover, we also continue to support refundable tax credits, which provide some relief to new enterprises, as well as management and technical assistance to fledgling entrepreneurs.

Secondly, Mayors continue to support the coordination of the tax incentives in the bill with other federal programs, including economic and community development, training programs, management and technical assistance for small businesses and other appropriate assistance programs. In this regard, we are pleased that enterprise zones would be linked with the creation of Foreign Trade Zones and the continued use, without restriction, of industrial development bonds.

It is unfortunate that many of the programs that should be tied in some way to enterprise zones have been or are proposed to be eliminated under the Reagan Administration's FY82 and FY83 budgets, including training activities, economic development and housing programs, adult and vocational education programs, industrial revenue bonds, and urban parks. In addition, other infrastructure programs have been cut substantially, including Urban Development Action Grants, EPA wastewater treatment programs, and public transportation subsidies.

One of the major worries of Mayors when the enterprise zone concept was first discussed last year was that the bill not be viewed as a substitute for proven ongoing federal programs. Yet, that is close to what has happened. I am very worried that this Committee not view enterprise zones in this fashion, especially in view of the unproven efficacy of tax incentives in revitalizing distressed neighborhoods.

Third, the Conference of Mayors opposes legislative language which would, in essence, require state and local governments to give HUD a guarantee that they will honor their commitments, or "lock in" their commitments before winning an enterprise zone designation. Such guarantees have never been given by the federal government and indeed are out of place in a governmental and democratic context.

In addition, we oppose the legal process supported by the Administration, whereby citizens or businesses in an enterprise zone can sue the city or the state for monetary damages and enforcement, should they fail to keep even one of their promised commitments. This distrust and disrespect for state and local governments is inconsistent with the thrust and general philosophy of the Administration's budget, economic and federalism programs. We strongly oppose the establishment of such a legal remedy on top of the many which already exist, as likely to result in a legal nightmare at the local level.

Fourth, we are concerned that HUD resist the temptation to impose its values and priorities on local governments, in terms of the commitments they must make if they are awarded one of the 13-25 zone designations. It is important that local governments have substantial flexibility in designing their commitment to an enterprise zone. After all, local officials and citizens know best what incentives are needed in their community to attract business investment and jobs -- whether regulatory changes, service increases, infrastructure improvements, or tax cuts. Although HUD officials have said that they will exhibit an "open mind" in evaluating state and local applications, the Administration proceeds to spell out the types of commitments which they will favorably consider -- e.g., changes in zoning ordinances, occupational licensing, economic development planning, the contracting out of services to the private sector, and the creation of neighborhood enterprise associations. These changes may not be appropriate in some cities whereas others, like crime control may be extremely important. We would urge this Committee, if an enterprise zone program is enacted, to request that HUD submit to the Congress for its prior approval the proposed criteria for designating zones before any zone designations are made. This will at least ensure that there is some open-mindedness about the process on the part of HUD. Better yet, we favor the greater flexibility incorporated in S.1310.

Fifth, we are concerned about the ability of the state to "veto" the creation of an enterprise zone. While the Conference of Mayors recognizes the importance of the state making a financial commitment to an enterprise zone, we do not believe it is sound or effective federal policy to require that the state must submit the enterprise zone application along with the local government, nor to require a state commitment. As you all know, the nature of the political process in some states may result in no enterprise zone designations, however distressed the area may be. Some Governors and state legislatures have never been very sensitive to the needs of distressed areas, and view any kind of targeting with anathema. Moreover, many state legislatures meet irregularly or at long intervals, which means that the formulation of the state commitment within a short period of time may be technically impossible. Thus, by mandating a state role, however desirable and important it may be, many cities will be precluded from participating in the enterprise zone program.

One final point concerns us. The Conference of Mayors, along with you, Senator Chafee, believes that the most important objective of enterprise zone legislation is to create jobs in distressed areas. On this score, I am uncertain whether the package provides enough employment incentives, however generous they appear to be. For example, most of the investment incentives -- the additional investment tax credit and the elimination of capital gains -- may be more attractive financially to many firms than the additional employment incentives. The result may be investment in labor-saving machinery which translates into a net loss of jobs or the "selling-out" by firms which have been in the area a long time and decide to avail themselves of the capital gains incentive. Clearly, this whole area of the efficacy of employment incentives versus investment incentives, needs to be examined in more depth.

Finally, the fact that the program is intended to be a small demonstration program for the first three years of its life is a disappointment. While I understand the merits of a demonstration program in some cases, it changes the nature of the program from an automatic tax program to a categorical program with the need for applications, reports, and bureaucratic negotiations. The small demonstration program which the bill proposes is unlikely to lead to widespread active support by Mayors across the country, since most Mayors will perceive that they are unlikely to ever have a zone designated in their city. For this reason, I believe it would make much more sense to enact a full-fledged automatic tax program or at the very least, a much larger demonstration program, of perhaps 100 zones each year.

Mr. Chairman, I thank you for the opportunity to present the views of the U.S. Conference of Mayors on enterprise zones. We fully support and sympathize with your goal of creating new investment and jobs in distressed urban areas, and we commend you for your openness to the views of Mayors and the other officials who must make enterprise zones work.

In view of the many reductions which have been made in urban programs and the desperate fiscal straits of many cities, I hope this Committee will move quickly to enact an enterprise zone bill. The Conference of Mayors looks forward to working with this Committee and the Congress on this and other tax legislation to encourage investment and job creation in distressed urban areas. Thank you.

Senator **Bradley**. Are either Mr. Moses or Mr. Schaefer concerned about two of the points that Mayor Primas raised, which was, first, the question of priority consideration given for designation of an area as an urban enterprise zone dependent upon tax abatement? Whether maybe you can't give the tax abatement that would qualify you for an urban enterprise zone. Is that a concern on your part as it is for Mayor Primas?

Mayor **Schaefer**. It is a concern of mine. The State legislation will have tax abatements in it, and we will have part and they will have the majority.

Tax abatement in our situation, when we have the highest tax rate in the State, and the surrounding areas reducing their tax rate this year, we are trying to hold. It's a problem.

Senator **Bradley**. Do you foresee a circumstance in which you could be, on the one hand, getting incentives from the Federal level, and on the other hand, having your basic tax structure eroded because you have to provide tax abatements to qualify for the Federal designation?

Mayor **Moses**. Yes. Secretary Chapoton, in particular, somewhat concerned me this morning when he said the initial thrust or the main emphasis may have to come from the State and the local governments. We have a fixed property tax; we do give tax abatements to new industries coming in in specific locations, and I think that we can concede to do that in some measure as long as there is some quantifiable certitude that there is going to be a benefit to our tax base in the future.

But we are truly up against the wall. I say that, particularly in Fort Wayne. We have had a little excess water problem this year and a little excess snow this year, and our budget is such that any dollar that is reduced will truly reduce services for the balance of the community. So we are at that very delicate balancing level, and reduction through tax abatements is a significant consideration by our city council and ourselves.

But it is important to consider.

Senator **Bradley**. I guess in Camden the problem is that if you had to compete with a more prosperous city on tax abatements, you would lose, and you would not get the urban Enterprise Zone.

Mayor **Primas**. Sure, particularly if that ranks very high on the selection criteria.

Senator **Bradley**. Could you talk a little bit about your other concern? I would like to hear from the other mayors, too, about the lack of specificity for the designation criteria.

Mayor **Primas**. Yes.

As I understand the act now, the Secretary has an awful lot of say-so as to the designation, and I think the terms are just rather general.

I would like to see a criteria spelled out, so that everyone knows what the rules are going in for the application. I think that would be in the best interests of all parties applying for designation.

Senator **Bradley**. Do the other two of you agree with that?

Mayor **Schaefer**. To a certain extent you need some flexibility, because each city is different. You ought to have some general rules but not make it so specific. For instance, if you would say we have to have a foreign trade zone, we're out. We have got a foreign trade zone in another area; we have done that before. It would be just duplicating.

If it was absolutely mandatory that we give tax abatements, we may again be out because of the Constitution. But if we can do it through the State, and that's why we put it in the State legislation that there can be tax abatements through the State—that is one of the things that we talked about earlier in this, to not make it so specific that you eliminate most of the cities in the very beginning.

So you have to have some ways to have flexibility on "either/or" in the applications.

Mayor **MOSES**. In regard to that question, speaking for Fort Wayne, one of the things that we have been most concerned about is the ambiguity of that decisionmaking. In fact, it's hard for us in Fort Wayne to determine how much in favor of this we can be. I think that's true of many cities throughout Indiana. As you may know, we have considerable unemployment—Fort Wayne is in the top 25 cities in the 100. We have the highest in the Nation.

Senator **BRADLEY**. I understand the interests of all three of you. Is there some meeting ground where you could be reassured that it's sufficiently flexible so that you are not cut out but so that each of you could be assured that at least you have some sense that—I assume you are interested—that you are going to get a fair shot?

Mayor **PRIMAS**. Yes.

Senator **BRADLEY**. What is the meeting ground here? Or maybe I should ask you, or the mayors, generally, to try to think if there is a meeting ground that you could advise the committee on.

Mayor **SCHAEFER**. We have been working on this.

Again, if you had to have all the unemployed from within the area, that wouldn't make any sense to me, because we have high unemployment all over the city.

That was one of the early provisos, and I think that was modified.

Senator **BRADLEY**. Do you think that it is too much to require that the high proportion of those who have jobs live in the city?

Mayor **SCHAEFER**. Oh, they ought to live in the city.

Mayor **MOSES**. I think we all agree with that.

Senator **BRADLEY**. You all agree with that? All live in the city?

Mayor **SCHAEFER**. Well, I think that's something that the mayors would do, anyway.

You see, right above that border, there, is an affluent county with a tax rate of $325 against $6. So I wouldn't be very pleased if their people came into an enterprise-zone area. While we work in a metropolitan concept, that's very important.

Senator **BRADLEY**. Do all of you think that EDA, UDAG, IRB's, and so forth, are essential to the success of this?

Mayor **PRIMAS**. I don't think there is any question about that. I don't think that the legislation we are speaking of today, in itself, is going to respond to the significant need that we have in the urban cities.

For it to be a success, I believe that it must be tied to existing programs so that we don't have to recreate the wheel. And if there could be additional commitments to the UDAG and EDA, I think that insures it's success.

Senator **Bradley**. One last question: Do any of you have any qualms at all about the refundability of the tax credit?

Mayor **Schaefer**. We looked at this, and I think the Federal Government is sort of against this. From the small business standpoint maybe you could work out a formula where you could get some cash refund rather than carrying it over.

You know, in trying to testify, you don't want to propose things that you know just aren't going to happen and have this tied up. For instance, I shouldn't mention this, but there should be two tiers of wages. That is something that you don't talk about, but I know from my own personal experience that that would help. And the same way with refundable.

The small business has to be able to survive those first couple of years. Now, how you write that and how you do that, that's going to take the technicians—an ability to be able to do it so that you don't do something wrong within it. There might be a percentage of a cash plus a carry. But the survival of those small businesses right in the first couple of years is important.

Venture capital, I think, is one of the early essentials, and that's why we put it in our State bill, so that there would be a revolving fund for small business to be able to survive.

Senator **Bradley**. How do you feel about the deductibility of $500,000 of capital investment?

Mayor **Schaefer**. I don't know the answer to that, and I don't want to speculate.

Senator **Bradley**. All right.

Mayor **Primas**. I raised the refundable tax credits in my discussion, because, again, I believe that the most significant problem that small businesses and medium-sized businesses are going to face is a cash problem.

As we heard from the mayor and a prior speaker, a significant number of new businesses have their problems in the first few years; so any mechanism that would provide more dollars to those businesses, I feel, would be substantial.

Mayor **Moses**. I would concur with both of them, that it is important that new dollars be available, whether it be a large G.E. or whether it would be a ma and pa store, that unless they have some venture capital, unless they have a refundability, it is unlikely that they are going to be able to overcome the interest rates and the dearth of capital available now, particularly in a midwestern city such as ours.

Senator **Bradley**. Thank you very much, gentlemen.

Senator **Chafee**. All right. Thank you, Senator.

Gentlemen, one quick question. Do you have problems with the State government having in fact a veto? Does that worry you?

Mayor **Schaefer**. It worries me.

Mayor **Primas**. Well, I've had pretty good discussions with our State government, so I'm not too concerned about that right now.

Mayor **Moses**. I addressed that on behalf of the Conference of Mayors, and it's a rather ubiquitous concern, I think, of most mayors. It's not meant as anything negative toward the Governors, but certainly we don't feel there should be a veto power.

Senator **Chafee**. Well, it's not labeled "veto," but in fact that is what it is. You can't go ahead unless you get approval.

Mayor **Moses**. That's right.

Senator **Chafee**. You don't like that, mayor?

Mayor **Schaefer**. I absolutely do not like it. I am a strong proponent of "directly to the cities," and not to the State. As I have told you, and I've testified that at the first crack out of the box—exactly what I said was going to happen—moneys are distributed on a population basis rather than on areas of need.

If a Governor has a veto power on things like this that directly affect our city, I worry.

Senator **Chafee**. Well, you know the objective. The objective was to get the State government aboard so they would be making contributions and participating.

Mayor **Schaefer**. We got them onboard by getting the law passed. In other words, we went to the State and we said, "In order for us to be able to be eligible, the State has to help." We also decided that there were other areas other than Baltimore City in need, and the enterprise zone was passed. But I would hate to have the Governor have the veto power, or something like this, when we worked so hard to get it.

Senator **Chafee**. Sure.

All right, fine. Thank you very much, gentlemen. We appreciate it.

Senator **Chafee**. Now, ladies and gentlemen, we have 13 more witnesses, because we have had to consolidate 2 days' hearings in 1 day. I would ask this: Please, no one address the matter of the importance of EDA and UDAG and CETA and SBA, and so forth. We accept that as given. This committee doesn't have control over those matters, and we recognize that they have to be there.

So, now I would ask Lieutenant Governor Mutz to come forward. You testified before.

And would everybody please summarize. If you have a new point, bring it out; but if we are plowing old ground, then you can touch on those matters rather briefly.

All right, Governor. We are delighted you are here. I had a nice chat with your Governor yesterday, and we want to hear what you have to say. And if you want to summarize, we would accept that cheerily.

STATEMENT OF HON. JOHN M. MUTZ, LIEUTENANT GOVERNOR OF THE STATE OF INDIANA

Lt. Governor **Mutz**. We understand that.

Senator, I am here on behalf of Gov. Bob Orr of Indiana and myself, and I speak here as the head of the Department of Commerce in the State of Indiana. We are one of those unique States in which the Lieutenant Governor is, by statute, assigned a specific administrative responsibility.

In an effort to summarize, I'll leave the written statement that we have prepared for the committee to review at another time.

I think it goes without saying that I am here in support of the bill that is before the committee at this particular time, on behalf of our State and the cities and communities in Indiana.

I think we also are here to indicate to you that we believe that this partnership arrangement between State government and local government and the Federal Government is essential; and, as a result, I would agree that the State government must have a signoff position in the problem.

It is important to recognize, first of all, that I believe each enterprise zone in the experiment which is proposed in this bill is one which must be a negotiated program. In Indiana we are moving toward the enactment of a piece of legislation which will put in place eight or nine specific options which may or may not be a part of each of the enterprise zone programs. Those options range all the way from tax abatement of property taxes to tax abatement of State taxes of one kind or another to specific waivers concerning regulatory authority and participation in certain State programs that require State funding, such as job training, for example.

It seems to me that pattern is one which is essential if we are to successfully negotiate an enterprise zone, and in turn, then, be competitive with the other States who will be seeking designation among what I'm sure will be a number of applications.

Briefly, there are only four things that I think need to be considered in this hearing, above and beyond the things you have already talked about.

The first of these I have mentioned, and that's the essential nature of the partnership relationship.

The second is that the designation process itself be postponed until later in fiscal year 1983. My point here, of course, is that a large number of States including Indiana have moved to enact and put in place enterprise zone legislation. It was our opinion and that of our general assembly—they liked the idea, but preferred to see what Federal guidelines looked like before passing enabling legislation.

This does not mean that we can't write tax abatement, we can't provide job training, we can't produce venture capital, and things of that kind; but it does mean that, in order to have waivers from the regulatory areas, we do have to have State legislation in place.

Senator CHAFEE. Well, you could get in on the next round. But it seems to me—I don't want to argue with you over this—but if we waited until the end of fiscal year 1983, you are talking of a year from now, and I think we ought to get going. But, never mind. Your point has been registered.

Lt. Governor MUTZ. Well, that's the purpose of being here.

Third, in referring to the venture capital needs, I want to mention to you a very special approach that might be considered by the committee, which could, in fact, be part of this legislation, I believe; that is, the setting aside of portions of existing SBA funds which are now available for leveraged lending by SBIC's, and granting a certain preference for the use of those funds if the equity capital investments are in fact made in a designated zone.

We are already experimenting with this particular idea in regard to an ACAP program in Indiana, in which we are making available certain funds to SBIC's who make equity investments in those particular communities where the ACAP program is in place.

Finally, of course, the fourth part of my presentation dealt with the need to incorporate work or job training funds availability. This could be a State responsibility. It does not have to be a Federal responsibility at all. As a matter of fact, we feel that, while those other programs that you talked about that ought to be integrated or linked to this program may be nice, it is not essential, as far as we are concerned. We can live with this bill in the form that it's in and make it work, provided that we have those two essential ingredients as criteria for the selection process.

Senator CHAFEE. What are the two criteria?

Lt. Governor MUTZ. Venture capital availability, which we think is an essential ingredient; and job training. Those two ingredients are absolutely essential if this is to work.

Senator CHAFEE. All right. That's helpful. Those are two good points you made, and we certainly will bear those in mind.

I want to review a minute the discussion we had on the getting ahead and not waiting until the end of the fiscal year. There will be other chances coming up in the next round, if Indiana waits. But, as you have heard the testimony, Kentucky, for example, already has its legislation in place.

Lt. Governor MUTZ. I agree that there are some States that moved ahead. But, for example, in the State of Ohio, their legislation is more restrictive in terms of qualifying factors than is the Federal legislation at this point.

The reason that we delayed was not because we couldn't have passed and not because we don't care about it, but because in fact we wanted to be in conformance with the Federal guidelines. I think you are kidding yourself if you aren't.

Senator CHAFEE. All right, fine, Governor. We appreciate your coming here, once again, and I hope you will convey to your Governor my best wishes.

Lt. Governor MUTZ. Well, Senator, my Governor sends his best wishes to you and his thanks for allowing me to testify, and also the tremendous amount of time and effort you have put into this project.

Senator CHAFEE. Fine. Thank you.

[The prepared statement follows:]

TESTIMONY BY LT. GOV. JOHN M. MUTZ OF INDIANA

When the enterprise zone idea first began to receive attention here in Washington, we decided to take our own look at how enterprise zones might work in Indiana. We wanted to get a feel for the effect of enterprise zones in our larger cities, like Indianapolis, Fort Wayne and South Bend . . . the hard-hit medium-sized cities like Muncie, Anderson and Kokomo . . . and smaller communities with different needs, like Seymour, Monticello and Greensburg.

The 1981 session of the Indiana General Assembly created an Enterprise Zone Commission to study how the idea might serve as a tool for the revitalization of Indiana's urban areas. The commission is composed of two legislators from each party, representatives of state and local government, and private citizens. The commission is just beginning its work, which is to monitor federal legislative initiatives, suggest legislation to our General Assembly which would allow Indiana to take advantage of any possible federal program, and to determine the merits of a state enterprise zone program, regardless of the fate of federal legislation.

Our goal is a legislative package to present to the 1983 session of the Indiana General Assembly when it convenes in January.

The enterprise zone concept is rooted in the belief that the real solution to the problems of urban blight is the creation of a favorable climate for private sector investment which will expand the economic opportunities for residents of these zones.

Clearly, a favorable investment climate requires more than low taxes and a cutback on regulations. It requires an infrastructure conducive to providing the basic services necessary for commercial enterprise—adequate police and fire protection, sanitation, transportation systems and utilities. These are functions which have traditionally been the responsibility of state and local government. Thus, the success of enterprise zones requires a true partnership between all levels of government. We'll succeed or fail together on this project. Enterprise zones also require us to recognize that economic tools which may work in one zone may not meet the needs of another.

The State of Indiana would urge this committee, as it debates its approach to enterprise zones, to consider the following suggestions:

First, enterprise zone designation and management should occur in a spirit of compromise and negotiation, in which each of the parties brings to the table its best contribution to structuring a successful zone. In other words, the traditional federal grantor-grantee relationship is inappropriate to this particular program. In this case, you need us and we need you.

Second, we ask that the designation process be postponed until later in the 1983 fiscal year. A large number of Indiana cities are preparing to compete for designation. We have no fear of the competitive process, in fact, we think its one of the programs' strong points. However, if the designation process begins in November, as planned, those states who felt it most responsible to hold their legislation for federal guidelines will not have the necessary time to offer legislation to their respective General Assemblies before the first round of zones are chosen. We suggest a postponement to allow full participation by all states, including those interested enough to have taken special legislative steps in their own behalf.

Third, we encourage the inclusion of specific federal program efforts to meet the venture capital needs of Enterprise Zone entrepreneurs.

Northeastern and midwestern distressed economies are especially dependent on small and medium sized firms for creation of new jobs. The Administration's enterprise zone proposals intends to focus on tax incentives, which are necessary. However, if we intend to encourage the formation of small and medium sized firms, it is important to include tools which enhance access to capital.

Indiana has recognized the need for a solution to this problem by establishing the Corporation for Innovation Development, which invests in newly established SBICs using investment capital attracted by tax credits. In addition, the Corporation makes direct investments in new businesses which are just beginning production and marketing activities.

A federal effort to pool venture capital would seem essential for the success of enterprise zones, and even disirable if not tied to enterprise zones. Ideas such as providing preferential SBIC leveraging with SBA funds or preferential interest rates for capital could provide the necessary funds to begin business in a distressed area.

Fourth, enterprise zone legislation needs to provide for job training.

Enterprise zones, by definition, will be located in pockets of high unemployment, in the middle of large numbers of unemployed people who may not possess the skills needed by the new companies in their midst. The way to match up the new jobs created with worker skills is to make sure job and managerial training and retraining is available in or near enterprise zones.

Indiana has already moved in this direction by creating the Industrial Training Program to assist new industry in hiring from the local labor force.

The use of federal initiatives such as the Quayle-Kennedy "Training for Jobs Act" which focuses attention on the vocational education system, could channel the necessary funds into the particular needs of the enterprise zone labor force.

By taking such steps as creating a vehicle for pooling venture capital, retraining programs for jobless workers, and a commission to study the enterprise zone concept, Indiana is clearly showing its interest in being a full partner with the federal government in helping solve our economic problems.

The era of federal-state paternalism is ending . . . a new era of partnership is beginning.

Clearly we are in a time that calls for private sector participation in the solutions to these problems. Experience indicates development cannot be artifically imposed upon a community. Long term self sustaining growth can only occur if the participants have a stake in economic development. The enterprise zone can be a vehicle for change if the roles of business, industry, neighborhood and voluntary organizations are clearly stressed as interdependent.

Governor Bob Orr and I appreciate this opportunity to be heard on this important new approach to urban revitalization. We hope that the enterprise zone will become a model for a new federal, state and local partnership that will yield new jobs and economic good health.

Thank you.

Senator CHAFEE. Mr. Carson from Connecticut, and Ms. Ruth Messinger from the New York City Council.

Mr. Carson, why don't you proceed.

STATEMENT OF JOHN J. CARSON, COMMISSIONER, CONNECTICUT STATE DEPARTMENT OF ECONOMIC DEVELOPMENT

Mr. CARSON. Thank you, Senator. I will try to be brief. You obviously have given us the indication to move along.

I think I would just talk from the perspective that Connecticut, as far as I know, is the first State to initiate legislation. We did not wait for mayors to tell us what Governor O'Neill supported in our State legislature. I will just briefly review with you why we thought that this was necessary legislation in our State.

I think, basically, we feel that—

One, cities are the area where you need the job producing investments.

Two, the overall success of any State's economy is dependent upon the ability of the urban area to retain vitality and grow again.

Three, as the traditional homes of industry, as we in the Northeast particularly know, it is an area that can accommodate new reinvestment.

In the mid-1970's we made the commitment in the State of Connecticut to urban economic development, and passed, in 1978, legislation called the urban jobs program, which had a wide range and which my testimony indicates what the components are of various incentives, which proved to us that you could attract, maintain, retain manufacturing investment within our distressed cities which, in Connecticut, were the 21 UDAG-eligible communities.

However, in reviewing that, it's obviously, much as the administration's bill, a very much capital-oriented kind of legislation, and we felt we had to move on to something which is more people-oriented. And that is what led to the introduction and the passage in 1981, and signing by Governor O'Neill of what we think is the first statewide enterprise zone legislation.

This would not only include benefits from the State level to manufacturing, but include benefits to retail, office, residential types of investments, as well as providing for, from the State level, infrastructure assistance, job training, and venture capital.

We think we have a number of substantive kinds of incentives, including local property tax abatement, and which, by the way, the State would reimburse to the community which is abating the property tax to the tune of 80 percent; we would reimburse that community 75 percent.

We have doubled our corporate income tax credit for new investments provided that 30 percent of the facility's employees in that facility live in the zone or are CETA eligible. And we have expanded other incentives under our original urban jobs legislation of 1978.

I think of note and of difference from the current legislation you are dealing with is, that we have created a venture capital and working capital program for loans, for businesses already in place who want to expand and grow within the zone as well as those that might want to start up. And we have done some other things as well.

We have tackled with our legislation, Senator, the question of just "churning," as I would call it, where you put in place incentives, where one would move from one part of the State of Connecticut or, for instance, one part of a community which could be designated as a zone, and move for movement's sake and only to take benefits. We have protection within our statute to avoid that kind of churning.

I would, in very brief closing, again just mention, as you have heard before but, I think, as a State which has moved on this and which believes very strongly in this concept, that this legislation, hopefully, as it is dealt with in these difficult times by your committee and by Congress, would emphasize the people issue. We have dealt with the capital issue. It does work. But we must move on to the people issue of providing job training capabilities. We must, I think, at the Federal level provide the venture capital programs that you have heard about, the support of infrastructures.

Finally, I have great difficulty with the particular portion of the legislation in the area of regulation. It is what I would call the "Dodge City mentality" of regulation pushing away. We have dealt with this issue at the State level. I think it is a promise or expectation that will not really be there.

Senator CHAFEE. What you are saying is that there is really not much chance of deregulating, as it were?

Mr. CARSON. I would say that it's not so much of a chance, Senator, as that issue may not be the swing factor that is going to be making the investment decision.

Senator CHAFEE. I really have a serious question of whether we even ought to mention the subject in connection with this legislation.

Mr. CARSON. I would wholeheartedly agree with you, sir.

Senator CHAFEE. It just opens up all areas of concern amongst the unions, or whoever it might be. I'm not sure it gets us anywhere.

Mr. CARSON. May I just make one final comment? I heard the bell, and I appreciate your patience.

We heard the Baltimore experience. Our expectations in the State of Connecticut, although we wish we had Control Data Corp., and we certainly would take them, I think we have to be realistic at both the State level and at the Federal level that those major kinds of investments in zones are going to be few and far between. If there are 75 Federal zones, I do not think you will see 75 major investments such as Control Data Corp. but small- and medium-size companies growing and expanding.

We support it; we certainly in the future would like to provide you and your committee with any of our experiences, as well.

Senator CHAFEE. Yes. We would like a copy of the Connecticut statute. If you could leave that with us, we would appreciate it.

Mr. CARSON. I have it here, sir, and I will pass it to your staff.

Senator CHAFEE. Thank you.

I saw your testimony of some of the industries. Unimation—isn't that the one that developed the robot?

Mr. **Carson**. That is interesting. That is the country's premier robotics company which has expanded in Waterbury, which is a distressed community in Connecticut. In addition, the Bridgeport Machines that I mentioned is just going into the robotics business, which proves that not only does old-line Northeastern manufacturing work but it can work in an urban area.

Senator **Chafee**. I just came back from Japan in January, and I saw your robots there, which I guess are being produced sometimes under license. Some of these were under license—Kawasaki, I believe it was.

All right, fine. Thank you.

Ms. Messinger.

STATEMENT OF MS. RUTH MESSINGER, MEMBER, CITY COUNCIL, NEW YORK, N.Y., FOR THE NATIONAL LEAGUE OF CITIES

Ms. **Messinger**. Thank you very much, Mr. Chairman. I am Ruth Messinger. I am a council member from New York City. I am also a member of the advisory council of the National League of Cities and delighted to be representing them here today.

Mindful of your request that I summarize our written testimony, let me say the league strongly supports the underlying concept of the enterprise zone legislation but does wish to put on the table several issues in addition to the one that you told me not to raise.

With regard to the eligibility criteria, while we are generally supportive of the criteria for designation, we do share a concern which you have raised several times this morning regarding the authority of the State to veto a local application. We think that States should be encouraged to provide additional business incentives and program support to local governments, but we would be reluctant to see the legislation pass with the veto provision.

Senator **Chafee**. Why?

Ms. **Messinger**. Because we think that there are localities, there are members of the league, that are ready to proceed with the plan, in the same way that in Connecticut the State has already developed its plan. We believe there are cities that are ready to proceed, and we have two concerns on behalf of those cities: One is what if the State is simply not interested in this as an available economic development and employment tool, or does not see this as a prime site and wishes to dispute it, yet in fact the package prepared by the locality is of interest to HUD and meets its criteria? We would like for that city to be able to proceed.

We are also concerned about a particular time deadline, and that is that the requirement that States as well as cities approve legislation authorizing enterprise zones within their jurisdictions may at least in the first year run into the problem, which I'm sure you are familiar with, of the timetables of various State and city legislatures. So we are concerned that, again, there may be localities that are ready to proceed.

We have heard from some of our members that they believe they are on target and ready for some piece of Federal legislation and prepared to make application, but that things are going very slowly in their States.

Senator **Chafee**. You wouldn't deny that it's all right to have HUD, when they are reviewing this, see what the State is doing?

Ms. **Messinger**. Absolutely not.

Senator **Chafee**. That could be a part of the criteria?

Ms. **Messinger**. I would assume that they should, and we would see all of our local members urging their States to pass enabling and supportive legislation. Obviously, that is likely to make the package better. The only reservation we are raising is to give them final veto power.

You will note that we are also a little bit concerned about the wording of a small portion of the legislation that gives the HUD Secretary the right to revoke a designation. While we don't want to deny the Secretary that right, we think that the legislation should be redrafted to ascertain that, should such a relocation be considered, the local government will be given time to develop some alternative, to consider some amendments to its package, to try to make things work better rather than to suddenly have the ax come down and have the commitments that were made broken.

Senator **Chafee**. That's a good point.

Ms. **Messinger**. With regard to the whole issue of the local commitment, we think that, to the extent that the legislation talks at some length about encouraging the local initiatives that best reflect local conditions, we are delighted to see that. We are convinced that out of that broad package of things that localities might do to qualify areas as enterprise zones there are things that are appropriate, different things that are appropriate, to various of our different members.

What we are tremendously concerned about, though, is a sentence in the administration's summary of the legislation that indicates that, in the process of evaluating the packages, one against each other, there is a quote: "Widespread willingness to include a particular element will therefore provide pressure for all applicants to include it." We are distressed that that may be used by HUD to counter precisely the kind of local initiatives that we think are necessary to make individual zones work and that we have respect for in the legislation.

As several of the last few witnesses representing cities and States indicated, we are very interested in improved employment targeting, a requirement that there be some kind of hiring guarantee for low-income workers, additional emphasis on job development and job training, and we are concerned that there is not yet enough being done for small businesses. And, despite the statement of the Secretary this morning, we would very much like to see that the tax credits provided in this legislation be made refundable and that additional assistance that seems particularly appropriate to the smaller businesses be included in the legislation.

I thank you.

Senator **Chafee**. You heard Secretary Chapoton on the refundability, didn't you?

Ms. **Messinger**. I did.

Senator **Chafee**. What about the proposal that Mr. Norris made about the 100-percent writeoff for investment in the first year?

Ms. **Messinger**. To the best of my knowledge, Mr. Chairman, the League itself does not have a position on that, and so I could not reflect it.

Senator **Chafee**. All right. Thank you very much, Ms. Messinger.

Ms. **Messinger**. OK. Thank you.

Senator **Chafee**. I appreciate both of you coming today.

Mr. **Carson**. Thank you, Senator.

[The prepared statements of the previous panel follow:]

STATE OF CONNECTICUT

Raised Committee Bill No. 5528 Page 1 46

Referred to Committee on Planning & Development

LCO No. 1575

ntroduced by (PD)

General Assembly,

February Session, A.D., 1982

AN ACT REVISING THE ENTERPRISE ZONES PROGRAM.

Be it enacted by the Senate and House of Representatives in General Assembly convened:

Section 1. Section 1 of public act 81-445 is repealed and the following is substituted in lieu thereof:

(a) Any municipality may, with the approval of the commissioner of economic development, designate an area of such municipality as an enterprise zone. Any such area shall consist of one or two contiguous United States census tracts, CONTIGUOUS PORTIONS OF SUCH CENSUS TRACTS OR A PORTION OF AN INDIVIDUAL CENSUS TRACT, as determined in accordance with the [1980] MOST RECENT United States census and, if such area is covered by zoning, a portion of it shall be zoned to allow commercial and industrial activity. [Any such area shall also meet at least one of the following criteria: (1) Twenty-five per cent or more of the population of such area shall have incomes below the poverty level, as defined by the United States Department of Labor; (2) twenty-five per cent or more of the population of such area shall be dependent on funds administered by the Connecticut department of income maintenance as their major source of income; or (3) twenty-five per cent or more of the labor force in such area shall be unemployed] THE CENSUS TRACTS WITHIN WHICH SUCH DESIGNATED AREA IS LOCATED SHALL ALSO MEET AT LEAST ONE OF THE FOLLOWING CRITERIA: (1) TWENTY-FIVE PER CENT OR MORE OF THE PERSONS WITHIN THE INDIVIDUAL CENSUS TRACTS SHALL HAVE INCOME BELOW THE POVERTY LEVEL, AS DETERMINED BY THE MOST RECENT UNITED

STATES CENSUS; (2) TWENTY-FIVE PER CENT OR MORE OF THE FAMILIES WITHIN THE INDIVIDUAL CENSUS TRACTS SHALL RECEIVE PUBLIC ASSISTANCE OR WELFARE INCOME, AS DETERMINED BY THE MOST RECENT UNITED STATES CENSUS; OR (3) THE UNEMPLOYMENT RATE OF THE INDIVIDUAL CENSUS TRACTS SHALL BE AT LEAST TWO HUNDRED PER CENT OF THE STATE'S AVERAGE, AS DETERMINED BY THE MOST RECENT UNITED STATES CENSUS. IF A CENSUS TRACT BOUNDARY LINE IS THE CENTER LINE OF A STREET, THE COMMISSIONER OF ECONOMIC DEVELOPMENT MAY INCLUDE WITHIN THE ENTERPRISE ZONE THAT PORTION OF THE PROPERTY FRONTING ON SUCH STREET WHICH IS OUTSIDE OF BUT ADJACENT TO THE CENSUS TRACT. THE DEPTH OF SUCH PROPERTY SO INCLUDED IN THE ENTERPRISE ZONE SHALL BE DETERMINED BY THE COMMISSIONER AT THE TIME OF THE DESIGNATION OF THE ZONE. IF MORE THAN FIFTY PER CENT OF THE PROJECT AREA OF A DEVELOPMENT PROJECT UNDER CHAPTER 132 OF THE GENERAL STATUTES IS LOCATED IN AN AREA ELIGIBLE FOR DESIGNATION AS AN ENTERPRISE ZONE AND THE PROJECT PLAN FOR SUCH DEVELOPMENT PROJECT IS APPROVED BY THE COMMISSIONER OF ECONOMIC DEVELOPMENT IN ACCORDANCE WITH SECTION 8-191 OF THE GENERAL STATUTES, THE COMMISSIONER MAY INCLUDE THE ENTIRE PROJECT AREA OF SUCH DEVELOPMENT PROJECT AREA IN AN ENTERPRISE ZONE. IF MORE THAN FIFTY PER CENT OF AN APPROVED REDEVELOPMENT AREA UNDER CHAPTER 130 OF THE GENERAL STATUTES IS LOCATED IN AN AREA ELIGIBLE FOR DESIGNATION AS AN ENTERPRISE ZONE, THE COMMISSIONER MAY INCLUDE THE ENTIRE REDEVELOPMENT AREA IN AN ENTERPRISE ZONE. IF THE COMMISSIONER DETERMINES THAT THE NECESSARY DATA IS NOT AVAILABLE FROM THE MOST RECENT UNITED STATES CENSUS, HE MAY USE SUCH DATA AS HE DEEMS APPROPRIATE.

(b) The commissioner of economic development shall approve the designation of six areas as enterprise zones, not more than three of which shall be in municipalities with a population greater than eighty thousand and not more than three of which shall be in municipalities with a population of less than eighty thousand, and shall adopt regulations in accordance with chapter 54 concerning such additional qualifications for an area to become an enterprise zone as he deems necessary. The commissioner may remove the designation of any area he has approved as an enterprise zone if such area no longer meets the criteria for designation as such an area set forth in this section or in regulations adopted pursuant to this section, provided no such designation shall be removed less than ten years from the original date of approval of such zone. THE COMMISSIONER MAY DESIGNATE ANY ADDITIONAL AREA AS AN ENTERPRISE ZONE IF THAT AREA IS DESIGNATED AS AN ENTERPRISE ZONE PURSUANT TO ANY FEDERAL LEGISLATION.

Sec. 2. Section 3 of public act 81-445 is repealed and the following is substituted in lieu thereof:

(a) Any municipality which has designated any area as an enterprise zone pursuant to section 1 of [this act] PUBLIC ACT 81-445, AS AMENDED BY SECTION 1 OF THIS ACT, shall provide, by ordinance, for the fixing of assessments on all real property in such zone which is improved during the period when such area is designated as an enterprise zone. Such fixed assessment shall be for a period of seven years FROM THE TIME OF SUCH IMPROVEMENT and shall defer any increase in assessment attributable to such improvements [, provided any such] ACCORDING TO THE FOLLOWING SCHEDULE:

YEAR	PERCENTAGE OF INCREASE DEFERRED
FIRST	100
SECOND	100
THIRD	50
FOURTH	40
FIFTH	30
SIXTH	20
SEVENTH	10

(b) ANY fixed assessment on any residential property shall cease if: (1) For any residential rental property, any dwelling unit in such property is rented to any person whose income exceeds two hundred per cent of the median family income of the municipality; or (2) for any conversion condominium declared after the designation of the enterprise zone, any unit is sold to any person whose income exceeds two hundred per cent of the median family income of the municipality.

(c) IN THE EVENT OF A GENERAL REVALUATION BY ANY SUCH MUNICIPALITY IN THE YEAR IN WHICH SUCH IMPROVEMENT IS COMPLETED, RESULTING IN ANY INCREASE IN THE ASSESSMENT ON SUCH PROPERTY, ONLY THAT PORTION OF THE INCREASE RESULTING FROM SUCH IMPROVEMENT SHALL BE DEFERRED. IN THE EVENT OF A GENERAL REVALUATION IN ANY YEAR AFTER THE YEAR IN WHICH SUCH IMPROVEMENT IS COMPLETED, SUCH DEFERRED ASSESSMENT SHALL BE INCREASED OR DECREASED IN PROPORTION TO THE INCREASE OR DECREASE IN THE TOTAL ASSESSMENT ON SUCH PROPERTY AS A RESULT OF SUCH REVALUATION.

(d) NO IMPROVEMENTS OF ANY REAL PROPERTY WHICH QUALIFIES AS A MANUFACTURING FACILITY UNDER SECTION 32-9p(d) OF THE GENERAL STATUTES SHALL BE ELIGIBLE FOR ANY FIXED ASSESSMENT PURSUANT TO THIS SECTION.

(e) ANY SUCH MUNICIPALITY MAY PROVIDE ANY ADDITIONAL TAX ABATEMENTS OR DEFERRALS AS IT DEEMS NECESSARY FOR ANY REAL PROPERTY LOCATED IN ANY SUCH ENTERPRISE ZONE.

Sec. 3. Subsection (a) of section 12-217e of the general statutes, as amended by section 4 of public act 81-445, is repealed and the following is substituted in lieu thereof:

(a) There shall be allowed as a credit against the tax imposed by this chapter an amount equal to twenty-five per cent of that portion of such tax which is allocable to any manufacturing facility, provided, for any such facility WHICH located in an enterprise zone designated pursuant to section 1 of [this act] PUBLIC ACT 81-445, AS AMENDED BY SECTION 1 OF THIS ACT, AFTER JULY 1, 1982, and for which thirty per cent of the employees of such facility [on the last day] DURING THE LAST QUARTER of the fiscal year of the corporation are residents of such zone, OR ARE RESIDENTS OF SUCH MUNICIPALITY AND ELIGIBLE UNDER THE FEDERAL COMPREHENSIVE EMPLOYMENT TRAINING ACT, a credit of fifty per cent shall be allowed.

Sec. 4. Subsection (a) of section 32-9l of the general statutes, as amended by section 6 of public act 81-445, is repealed and the following is substituted in lieu thereof:

(a) An eligible business facility shall be granted an amount determined by multiplying five hundred dollars or, in the case of any facility located in an enterprise zone, FOR WHICH THIRTY PER CENT OF THE EMPLOYEES OF SUCH FACILITY DURING THE LAST QUARTER OF THE FISCAL YEAR OF THE CORPORATION ARE RESIDENTS OF SUCH ZONE, OR ARE RESIDENTS OF SUCH MUNICIPALITY AND ELIGIBLE UNDER THE FEDERAL COMPREHENSIVE TRAINING ACT, one thousand dollars, by the increase in the number of full-time employment positions, the costs of which are paid by the eligible business, directly resulting from the construction, renovation or expansion of the business facility, as determined by the department taking into account the employment requirements of business expansion, historical levels of employment and employment positions prior to the expansion, and such other factors as the department may deem appropriate.

Sec. 5. Section 7 of public act 81-445 is repealed and the following is substituted in lieu thereof:

The commissioner of economic development shall establish and administer a program of SMALL BUSINESS LOANS OR venture capital loans to persons seeking to establish, EXPAND, RENOVATE OR REHABILITATE small businesses within an enterprise zone established pursuant to section 1 of [this act] PUBLIC ACT 81-445, AS AMENDED BY SECTION 1 OF THIS ACT. The commissioner shall adopt regulations in accordance with chapter 54 of the general statutes concerning the qualifications for and terms of such loans.

Sec. 6. (NEW) No business facility shall be eligible to receive the benefits of public act 81-445, as amended by this act, if: (a) Such facility has relocated from an area that meets the eligibility criteria stated in section 1 of said act for designation as an enterprise zone; or (b) such facility was originally located in a distressed municipality, as defined in section 32-9p of the general statutes, and relocated into a designated enterprise zone; provided that in cases where the commissioner of economic development finds that the relocation of the business facility will represent a net expansion of business operations and employment, the business facility shall be eligible. For the purposes of this section, relocation is defined as the transferring of personnel or employment positions from one or more existing locations to another location.

Sec. 7. This act shall take effect July 1, 1982.

STATEMENT OF PURPOSE: To provide for more equitable and efficient operation of the enterprise zone legislation.

[Proposed deletions are enclosed in brackets. Proposed additions are all capitalized or underlined where appropriate, except that when the entire text of a bill or resolution or a section thereof is new, it is not capitalized or underlined.]

STATE OF CONNECTICUT
DEPARTMENT OF ECONOMIC DEVELOPMENT

JOHN J. CARSON
Commissioner

PETER F. BURNS
Deputy Commissioner

April 21, 1982

TESTIMONY

UNITED STATES SENATE
COMMITTEE ON FINANCE
SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

Chairman Chafee, members of the Subcommittee: My name is John J. Carson, and I am Commissioner of the Connecticut Department of Economic Development.

The State of Connecticut has long made targeted urban investment the centerpiece of our overall economic development policy for three basic reasons:

- Our cities need the new job-producing investments the most;
- Our overall state economic success is largely dependent on the health and vitality of our urban areas;
- Urban centers, as the traditional homes of industry, are in a unique position to reap the positive benefits of the nation's current drive for re-industrialization.

That is why I come before you to offer my enthusiastic support for some type of national "Urban Enterprise Zone"

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program. I urge you to move swiftly on such a concept because I believe it will (1) provide a real and needed incentive to the reindustrialization process and (2) provide jobs for the urban populations who sorely need employment.

We, as a nation, now more than ever, must proceed with an extremely innovative development policy, but with a sensitive and well-structured policy in order to stimulate the entrepreneurship and job generation which has been lacking in our economically depressed areas. We must be cautious that in our rush to "capital" formation, we do not forget the "people" aspects of this visionary approach. We must also ward off the temptation to engage in fleeting "economic giveaways" at a time when American industry has an obligation to become a partner with government in solving our common economic ills.

The President's enterprise zone proposals have considerable merit, yet they appear to rely too heavily on investment incentives and not enough on the people benefits such as job training and retraining, small business working capital and infrastructure investment. We, in Connecticut, believe we have developed -- over the past four years -- a model enterprise zone-type of program that addresses the full complement of urban needs.

Many states have been struggling for years with the long-term economic structural problems of their cities. And, we all know very well the consequences of failure in this endeavor ... the waste of human talent, the economic stagnation, the social turmoil, and the exhausting frustrations amongst residents, businesses and government.

Hard experience has also taught us that whatever assistance may come from the federal government, the state governments themselves must play a key role in stimulating urban economies. Our experience in Connecticut demonstrates, I think, quite clearly that states can play a leadership role in helping to rebuild urban areas and to open doors to minorities who have long been excluded from the economic mainstream.

In the mid-1970's Connecticut faced economic problems common to many industrialized states in the North: old plants, declining industries, economically decaying cities, and high unemployment. It led us to institute a carefully-planned economic development strategy and slowly but surely our economic situation began to turn around.

Even with the general improvement in our economic situation in the last five or six years, we were well aware of enduring problems in our urban areas. Our cities were faced with unique problems that required unique approaches. We knew the major effort was going to have to come from the state level.

One essential part of our strategy to help the urban areas was a far-reaching piece of legislation in Connecticut which, in effect, created the state's first enterprise zones in 1978.

It is a daring program providing an array of tax and other "capital" financing incentives to target manufacturing -- not commercial or retail -- investment in the state's cities and other areas where manufacturing has traditionally been centered and where minorities live and work. Underlying the whole program was our strong belief that the private sector can be influenced by state government if the state takes the initiative and does not simply react to crises. Specifically, the major parts of our first enterprise zone program are:

* 80 per cent abatement of local property taxes for five years. To ease the burden on the cities, the state reimburses them for 75 per cent of the abated taxes;
* 25 per cent reduction in the state corporation business tax for 10 years;
* $500 grant for each full-time permanent job resulting from the investment;
* Interest rate reductions on state-backed direct building and equipment loans;
* Working capital loans for small manufacturers.

It is my firm belief that the program is one of the most important economic programs ever enacted in the State of Connecticut. How has it worked for the past four years? The experience of Hi-G in Hartford, G & O Manufacturing in New Haven, Anaconda Metal Hose in Waterbury, and Bridgeport Machines in Bridgeport, illustrates our successes. Not only has this program helped existing companies modernize, remain and expand in our cities, but the program has attracted new fast-growing company expansions such as Unimation in Waterbury and Canberra Industries in Meriden.

With the help of these enterprising incentives, Hi-G built the first new manufacturing plant in Hartford in 25 years. The company now employs 750 people in this plant and the workforce is drawn primarily from the inner-city. G & O has a 60 per cent minority workforce which has been retained by the firm's ability to build a new factory across town. Overall, the program has generated well over $420 million in new investments for some 200 manufacturers and involving an estimated 20,000 jobs.

That's the "capital" program we initiated in 1978. Its success convinced us that more was needed to be done on the "people" level of the program in order to stimulate investments in those inner city neighborhoods that continued to suffer from extremely high unemployment. The development of downtown areas with attractive new office buildings and shopping areas has given the cities a real boost, yet few of the benefits flow into the inner city neighborhoods where the people live. We realized it would take greater incentives and more tailored "people" programs in order to attract meaningful productive development in these hardcore unemployment areas.

Last summer, the Connecticut General Assembly passed, and Governor Bill O'Neill signed, the nation's first "Enterprise Zone" legislation expanding the investment incentives and and eligibility for areas designated as zones. This legislation not only covers retail, office, residential, and manufacturing investments, but it also provides for infrastructure assistance, job training, and venture capital for small business entrepreneurs -- truly a means to channel the benefits to the residents of the zones.

We will be designating, over the next five months, six enterprise zones in Connecticut, determined by data from the 1980 census. The incentives are:

* Same property tax abatement;
* Seven-year freeze on assessed value of improved property in an enterprise zone;
* 50 per cent state corporation business tax reduction for 10 years, provided 30 per cent of the facility's employees live in the zone;
* $1,000 for each new full-time job;
* Special job training grants to employers for workers who live within the enterprise zones. Employers will be given vouchers for training that the companies will present to the state for payment.
* Creation of venture capital and working capital loans to persons who want to start small businesses in the zones.
* Replacement parts for machinery and equipment in the zones will be exempt from the state sales tax.

We in Connecticut feel we have a leg up on the national discussion of enterprise zones because we have demonstrated success with an initial enterprise zone-type program. We feel we can serve as a model to the rest of the nation, and are in a logical position to show our own commitments to the program when federal legislation finally chooses areas for which federal zones will be designated.

I urge you to consider several items in your deliberations over a national program:

* Emphasize "people" as much as possible -- supplement the investment incentives with job training capabilities that will match enterprise zone investments with the very people we are trying to assist;
* Help the enbattled entrepreneur make his or her contribution in the zones with working or venture capital assistance -- they will never be able to do anything without that extra edge;
* Assist the communities in their revitalization of services, roads, utilities, etc. It makes no sense to prop up a new investment in an area that will be decaying right out from under the business willing to make what is generally a risky business decision.
* Abandon thoughts of wholesale elimination of important regulations by communities and states. Connecticut and, I am sure, other states pride themselves on the ability to foster balanced economic growth that does not proceed pell-mell into development at the expense of the quality of life and environment. Responsible businesses

will be willing to abide by these standards.

"Enterprise Zones" can become a far-reaching national program to foster the concept of reindustrialization so badly needed during these difficult economic times and in the face of unprecedented competition in the world marketplace.

I urge you to consider the development of such a program wisely and with great care, for while enterprise zones will never be the "cure all" to our current economic weaknesses, they can be the beginning of a national policy that forges the critical public sector/private sector partnership required for improving the quality of life for all our citizens.

If you have any questions about Connecticut's programs and policies, I will be happy to answer them.

Thank you,

JJC:gmh

STATEMENT
OF
RUTH MESSINGER, COUNCIL MEMBER, NEW YORK, NEW YORK
FOR THE
NATIONAL LEAGUE OF CITIES
APRIL 15, 1982

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, I AM RUTH MESSINGER, COUNCIL MEMBER FROM NEW YORK CITY. I AM ALSO A MEMBER OF THE NATIONAL LEAGUE OF CITIES ADVISORY COUNCIL.

NLC REPRESENTS OVER 15,000 MUNICIPALITIES THROUGH OUR NETWORK OF STATE MUNICIPAL LEAGUES AND ABOUT 1,000 DIRECT MEMBER CITIES. I AM PLEASED TO BE HERE TODAY TO EXPRESS THE VIEWS OF NLC ON S. 2298, THE ENTERPRISE ZONE TAX ACT OF 1982.

NLC STRONGLY SUPPORTS THE UNDERLYING CONCEPT OF THE ENTERPRISE ZONE LEGISLATION TO STIMULATE ECONOMIC GROWTH AND EMPLOYMENT IN AREAS OF POVERTY AND HIGH UNEMPLOYMENT BY ENCOURAGING BUSINESSES, THROUGH FEDERAL AND LOCAL TAX INCENTIVES AND REGULATORY RELIEF, TO START UP, REMAIN, OR EXPAND IN SUCH AREAS. BECAUSE THE ADMINISTRATION'S BILL, S. 2298, IS BASED ON MANY OF THE PROVISIONS OF S. 1310, (THE URBAN JOBS AND ENTERPRISE ZONE ACT OF 1981), CO-SPONSORED BY SENATORS CHAFEE AND BOSCHWITZ, WE BELIEVE IT IS RESPONSIVE TO MANY OF THE CONCERNS WE HAD WITH PREVIOUS ENTERPRISE ZONE LEGISLATION.

THE FOLLOWING COMMENTS REPRESENT OUR VIEWS ON THE MAJOR PROVISIONS OF THE BILL:

ELIGIBILITY AND DESIGNATION

NLC GENERALLY SUPPORTS THE ELIGIBILITY AND DESIGNATION PROCESS CONTAINED IN THE BILL, WHICH REQUIRES THAT ALL ZONES BE LOCATED IN URBAN DEVELOPMENT ACTION GRANT (UDAG) CITIES OR POCKETS OF POVERTY, AND THAT CERTAIN LEVELS OF DISTRESS BE MET BY THE DESIGNATED ZONES.

AS WE INDICATED IN PREVIOUS TESTIMONY ON S. 1310, THE UDAG ELIGIBILITY CRITERIA WERE AGREED TO AFTER CONSIDERABLE DEBATE BY THE CONGRESS DURING THE REAUTHORIZATION OF THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM IN 1977 AND 1979. THEY HAVE ACQUIRED LEGITIMACY AS AN EXTREMELY EFFECTIVE MECHANISM FOR TARGETING LIMITED PUBLIC RESOURCES TO ECONOMICALLY DISTRESSED COMMUNITIES. IN ADDITION, USE OF THIS ESTABLISHED SET OF CRITERIA WILL FACILITATE THE COORDINATION OF ENTERPRISE ZONES WITH UDAG AND OTHER DEVELOPMENT PROGRAMS.

UNDER THE ADMINISTRATION'S BILL, AN ENTERPRISE ZONE MUST BE JOINTLY NOMINATED BY LOCAL AND STATE GOVERNMENTS, WITH EITHER HAVING THE POWER TO BLOCK A NOMINATION. ALTHOUGH WE BELIEVE STATES SHOULD BE ENCOURAGED TO PROVIDE ADDITIONAL BUSINESS INCENTIVES AND PROGRAM SUPPORT TO LOCAL GOVERNMENTS, THEY SHOULD NOT HAVE VETO POWER OVER ELIGIBILITY OR APPLICATION PROCEDURES. SIMILARLY, IF A STATE NOMINATES A LOCAL GOVERNMENT FOR ZONE DESIGNATION, THIS SHOULD OCCUR ONLY AT THE SPECIFIC WRITTEN REQUEST AND WITH THE FULL APPROVAL OF THE LOCAL GOVERNMENT. AFTER ALL, THESE ARE URBAN ENTERPRISE ZONES!

A RELATED CONCERN IS THE REQUIREMENT THAT LOCAL AND STATE GOVERNMENTS MUST JOINTLY PASS ENABLING LEGISLATION CREATING THE LOCAL INCENTIVES TO BE CONTRIBUTED TO EACH ZONE IN ORDER

TO APPLY FOR ZONE DESIGNATION. SEVERAL CITIES HAVE INDICATED THAT THEIR STATES ARE PROCEEDING SLOWLY IN PROVIDING SUCH ENABLING LEGISLATION. THIS SITUATION IS FURTHER COMPLICATED BY THE SHORT AND VARIED PERIODS THAT STATE LEGISLATURES MEET, WITH THE RESULT THAT MANY CITIES WILL NOT BE ABLE TO COMPETE IN THE ZONE DESIGNATION PROCESS. WE REPEAT, JOINT DESIGNATION SHOULD NOT BE INCLUDED IN THE LEGISLATION.

IN ADDITION, THE LEGISLATION PROVIDES THAT THE HUD SECRETARY MAY REVOKE A DESIGNATION IF THE LOCAL GOVERNMENT IS NOT COMPLYING SUBSTANTIALLY WITH ITS COMMITMENT WITH RESPECT TO ITS PROMISED PACKAGE OF INCENTIVES AND CONTRIBUTIONS. WE THINK SUCH A PROVISION MAY BE NEEDED; BUT IT SHOULD INSTRUCT THE SECRETARY, PRIOR TO REVOKING A DESIGNATION, TO NOTIFY THE AFFECTED LOCAL GOVERNMENT AND TO EXHAUST ALTERNATIVE REMEDIES, INCLUDING PERHAPS AMENDING THE COMMITMENT PACKAGE. (SUCH AN AMENDMENT MIGHT BE RELEVANT ANYWAY IF CHANGING CIRCUMSTANCES IN A SUCCESSFUL ZONE RENDERS A PART OF THE COMMITMENT PACKAGE IRRELEVANT OR EVEN DETRIMENTAL.) FURTHERMORE, POTENTIAL REVOCATION RAISES THE QUESTION OF WHAT WOULD THEN HAPPEN TO BUSINESS' ELIGIBILITY FOR TAX INCENTIVES DURING THE PERIOD OF TIME THAT THEY WOULD OTHERWISE HAVE BEEN IN EFFECT.

LOCAL COMMITMENT

NLC STRONGLY SUPPORTS THE FLEXIBLE PACKAGE OF ACTIONS BY WHICH LOCAL GOVERNMENTS CAN DEMONSTRATE THEIR COMMITMENT TO THE SUCCESS OF THE ZONES AND REDUCE SOME OF THE BURDENS BORNE BY EMPLOYEES AND EMPLOYERS IN THE ZONE.

WE BELIEVE THAT IT IS CRITICALLY IMPORTANT TO ENCOURAGE LOCAL INITIATIVES THAT BEST REFLECT LOCAL CONDITIONS. IN SOME JURISDICTIONS, LOCAL SALES, CORPORATE, OR INVENTORY TAXES MAY FREE UP MORE BUSINESS CAPITAL AND THUS BE GREATER INCENTIVES TO INVESTMENT THAN PROPERTY TAX REDUCTIONS. THE WAIVING OF LOCAL REGULATIONS OR REQUIREMENTS, TECHNICAL ASSISTANCE PROGRAMS, "ONE-STOP" OFFICES FOR CITY LICENSES, CODE COMPLIANCE, AND SO FORTH WOULD ALL PROVIDE VALUABLE INCENTIVES TO ENHANCE THE ZONE'S EFFECTIVENESS.

ALTHOUGH THE ADMINISTRATION HAS INDICATED THAT THE FEDERAL POSTURE TOWARDS THESE LOCAL CONTRIBUTIONS WILL BE FLEXIBLE, THEY ALSO STRESS THAT THESE PACKAGES WILL BE COMPETITIVELY EVALUATED AGAINST EACH OTHER. "WIDESPREAD WILLINGNESS TO INCLUDE A PARTICULAR ELEMENT WILL, THEREFORE PROVIDE PRESSURE FOR ALL APPLICANTS TO INCLUDE IT."

IN THIS REGARD, WE ARE CONCERNED WITH THE EXAMPLE CITED IN THE ADMINISTRATION'S FACT SHEET ON ENTERPRISE ZONES, WHICH INDICATES THAT ONE WAY TO GUARANTEE THAT LOCAL GOVERNMENTS CARRY OUT THEIR PROMISED COMMITMENTS TO THE ZONE "WOULD BE TO PROVIDE ZONE BUSINESSES, EMPLOYEES OR RESIDENTS THE RIGHT TO SUE THEM IN COURT". WE BELIEVE THIS AMOUNTS TO OVERKILL WHERE HUD HAS THE POWER TO REVOKE DESIGNATION FOR NON-COMPLIANCE AND WE HOPE THIS IS NOT INDICATIVE OF THE ADMINISTRATION'S OVERALL VIEW OF THE LOCAL GOVERNMENT SELECTION PROCESS FOR ENTERPRISE ZONE DESIGNATION.

EMPLOYMENT TARGETING

AS YOU KNOW, UNDER S. 1310, THE CHAFEE-BOSCHWITZ ENTERPRISE ZONE BILL, THERE WAS A REQUIREMENT THAT BUSINESSES IN A

ZONE HIRE AT LEAST 40 PERCENT OF THEIR NEW EMPLOYEES COME FROM THE CETA ELIGIBLE POPULATION. THE ADMINISTRATION'S BILL DOES NOT REQUIRE FIRMS TO HIRE A MINIMUM PERCENTAGE OF LOW-INCOME WORKERS IN ORDER TO QUALIFY FOR THE TAX INCENTIVES. WHILE NLC DOES NOT ENDORSE A FIXED PERCENTAGE OF CETA ELIGIBLE WORKERS FOR THE ZONE, WE DO BELIEVE THERE SHOULD BE SOME KIND OF HIRING GUARANTEE FOR LOW-INCOME WORKERS.

WE ARE PLEASED THAT THE ADMINISTRATION'S BILL INCLUDES A PROVISION ALLOWING EMPLOYERS A TAX CREDIT FOR WAGES PAID TO ZONE EMPLOYEES WHO WERE ALSO DISADVANTAGED WHEN HIRED. THE CREDIT, EQUAL TO 50 PERCENT OF ELIGIBLE WAGES IN THE FIRST THREE YEARS OF EMPLOYMENT, DECLINING BY 10 PERCENT IN EACH SUBSEQUENT YEAR, WOULD BE IN ADDITION TO THE 10 PERCENT TAX CREDIT FOR PAYROLL PAID TO ZONE EMPLOYEES. NLC BELIEVES THIS PROVISION ADDRESSES ONE OF THE MAJOR PURPOSES OF THIS PROGRAM TO CREATE JOBS FOR THE UNEMPLOYED AND UNDEREMPLOYED LOW AND MODERATE INCOME CITIZENS.

TAX INCENTIVES

NLC SUPPORTS GENERALLY THE USE OF TARGETED TAX INCENTIVES TO CREATE JOBS, ATTRACT INVESTMENT, AND ENCOURAGE LOCAL ENTREPRENEURSHIP. FOR THE ZONES PROGRAM, WE BELIEVE THE INCENTIVES TO BE PROVIDED SHOULD BE RELEVANT TO THE NEEDS OF A VARIETY OF SIZES AND TYPES OF BUSINESSES AND ARE SUFFICIENTLY ORIENTED TOWARD EMPLOYMENT TO ACHIEVE THE JOB CREATION GOALS OF THE PROGRAM.

ALTHOUGH THE ADMINISTRATION'S BILL INCLUDES A SERIES OF NON-REFUNDABLE TAX CREDITS TO STIMULATE HIRING, WE URGE THAT THESE TAX CREDITS BE MADE REFUNDABLE. SUCH A PROVISION WOULD

BE PARTICULARLY BENEFICIAL TO SMALL AND NEW FIRMS THAT HAVE LITTLE OR NO PROFIT AND THUS WOULD NOT FIND THE TAX REDUCTIONS RELEVANT. IN ADDITION THE PROVISION OF ENTREPRENEURIAL TRAINING AND MANAGEMENT ASSISTANCE ARE ELEMENTS ESSENTIAL TO SMALL BUSINESS START-UPS, ESPECIALLY IN FAILED MARKETS OF OUR INNER CITIES.

THE OTHER TAX INCENTIVES CONTAINED IN THE BILL MUST BE ASSESSED AS TO THEIR PROBABLE EFFECTIVENESS IN ACTUALLY ATTRACTING INVESTMENT AND CREATING JOBS IN A WIDE VARIETY OF TYPES AND SIZES OF FIRMS; AND--THEIR EFFICIENCY AS REGARDS THEIR COST RELATIVE TO THE BENEFITS THEY CREATE. THEREFORE, THE TAX PROVISIONS IN THIS BILL MUST BE LOOKED AT IN RELATION TO CHANGES IN THE TAX CODE AS A RESULT OF THE PASSAGE OF P.L. 97-34, THE ECONOMIC RECOVERY TAX ACT OF 1981, TO DETERMINE IF ENTERPRISE ZONES HAVE A COMPARATIVE COST ADVANTAGE TO BUSINESSES GIVEN THAT THE SAME TYPES AND BUT NOT NECESSARILY MAGNITUDES OF TAX INCENTIVES ARE PROVIDED REGARDLESS OF WHERE THEY LOCATE. OTHERS WITH MORE TECHNICAL EXPERTISE WILL COMMENT ON THESE AND RELATED ISSUES.

RELATED FEDERAL PROGRAMS

THE ADMINISTRATION'S BILL FAILS TO TAKE INTO CONSIDERATION THE ADDITIONAL COSTS THAT A CITY WILL PROBABLY INCUR IN A DESIGNATED ZONE. THESE MAY INCLUDE INFRASTRUCTURE EXPENDITURES THAT MIGHT NOT OTHERWISE HAVE BEEN NEEDED, ESPECIALLY THOSE ASSOCIATED WITH THE NEEDS OF A PARTICULAR PROJECT, INCREASED POLICE, FIRE, OR OTHER PUBLIC SERVICES RESULTING FROM GREATER ECONOMIC ACTIVITY; AND COSTS ASSOCIATED WITH PROMOTING THE ZONE TO FIRMS, ADMINISTERING CODES, ZONING REGULATIONS, OR

PROVIDING TECHNICAL ASSISTANCE TO FIRMS.

WE URGE THE COMMITTEE TO KEEP IN MIND THAT WHILE ENTERPRISE ZONES MAY BE A USEFUL ADDITION TO EXISTING PROGRAMS, IT MUST AND CANNOT BE A SUBSTITUTE FOR THEM. WITHOUT ADEQUATE FUNDING FOR OTHER ECONOMIC DEVELOPMENT AND LABOR PROGRAMS, THE ENTERPRISE ZONE PROGRAM WILL BE FAR LESS SUCCESSFUL THAN OTHERWISE. PROGRAMS LIKE EDA'S PUBLIC WORKS GRANTS COULD PROVIDE THE INFRASTRUCTURE FUNDS NECESSARY FOR INCREASED ECONOMIC ACTIVITY; HUD'S UDAG GRANTS COULD PROVIDE THE NECESSARY FRONT-END ASSISTANCE FOR NEW FIRMS; AND JOB TRAINING COMPONENTS UNDER CETA COULD PROVIDE THE TRAINING NECESSARY FOR THE STRUCTURALLY UNEMPLOYED.

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU AND PRESENT THE VIEWS OF THE NATIONAL LEAGUE OF CITIES.

THANK YOU.

Senator CHAFEE. The next panel—Mr. Revzan, Dr. Butler, and Mr. Paul Pryde.

Mr. Revzan, why don't you proceed.

Mr. REVZAN. Thank you very much, Mr. Chairman.

Senator CHAFEE. We have had the privilege of seeing you gentlemen before here to testify.

Dr. Butler has been long active, and I remember Mr. Pryde.

All right, Mr. Revzan, why don't you proceed?

STATEMENT OF LAWRENCE REVZAN, DIRECTOR, COOPERS & LYBRAND, WASHINGTON, D.C.

Mr. REVZAN. Thank you very much, Mr. Chairman.

My name is Larry Revzan, Director of Economic Development Consulting at Coopers & Lybrand. My background includes over 10 years of work in economic development for both public and private sector clients. In the past year I have done a considerable amount of research on enterprise zones and have made presentations before several groups on the relationship between enterprise zones, overall economic revitalization of distressed areas, and Federal tax policy.

It is my distinct pleasure to be here today to present my observations and recommendations on the Enterprise Tax Act of 1982.

Senator CHAFEE. Mr. Revzan, I'm afraid you are going to have to summarize. This is 11 pages.

Mr. REVZAN. Well, I've shortened this down.

First of all, I would like to indicate that we at Coopers & Lybrand have developed a model that simulates the effects of different tax provisions and different incentives on business performance. And the business that we have looked at can be hypothetical or real, small, large, any type of SIC code.

I would like to take the opportunity just to summarize briefly some of the findings that we have arrived at thus far in running some numbers through our model.

First, we found that a business can add significantly to its cash flow and after-tax profitability merely by taking advantage of existing State and local incentives, for example, property tax abatement, use of industrial revenue bonds, and so forth.

Second, when adding the types of provisions that States have talked about in enterprise zone legislation, a little less than 1 percent per year is added to cash flow. In other words, you get a marginally greater impact.

The same thing holds if, in fact, you add the Federal incentives talked about to the State and local incentives that are already in place. There are several reasons for that, and I would be happy to comment on that later during the question session.

In comparing the provisions of Senate bill 2298 and some of the other bills, for example, Kemp-Garcia that was introduced previously, what we found is that the administration bill has a more significant impact on cash flow and after-tax profits in the initial years through the use of tax credits and other incentives. But incentives such as the 50-percent gross receipts exclusion from income proposed in the Kemp-Garcia bill may become more significant in years 3 and beyond. So we feel that that should be looked at again and be carefully analyzed.

And we have been running some results of our model for other of our clients, and we would be happy to share those with you.

Now, just to summarize briefly a few points. The first two have been made before, on the need for infrastructure development, and also the capital formation needs of small businesses. I think Mr. Pryde and Mr. Butler will be talking about that in particular.

A third point in summary is that enterprise zones must provide tax incentives that have a significant differential impact on those already provided in the Economic Recovery Tax Act of 1981. From the results of our analysis, it is unclear at this time, particularly for small start-up businesses and/or new or expanding businesses of a small- and medium-size nature, whether in fact this is the case.

Another point is that we feel incentives should be directed to, where possible, cost reduction and improved cash flow, or top-line management as opposed to bottom-line tax reduction measures. Incentives that reduce the costs of capital and wage costs are likely to be more effective than added investment tax credits and targeted jobs tax credits.

An additional point, and related to that, is that we feel that incentives specifically focusing on reducing the costs of labor should be addressed to the ability of the business to absorb unskilled workers into entry level jobs.

I think you have heard some testimony previously that a recent report published through the Labor Department indicates that targeted jobs tax credits to date have been relatively ineffective, for a variety of reasons. Although the proposed bill deepens those credits or makes them significantly more attractive financially to a particular business, it has, again, not been demonstrated previously that that program has been an effective tool in leading to job creation.

The Private Sector Opportunities Act, which has been introduced in the House by Representatives Kemp, Garcia, and Gray, recognizes that problem explicitly and seeks to strengthen the private sector initiatives program in enterprise zones. We would concur with that, and would argue, as other witnesses have, that there should be a significant training component targeted to these zones.

I have heard the bell and will try to summarize quickly.

An additional point: There is a question in our minds, and this point has been made previously, whether the program is strictly experimental in nature, as some contend on the administration's part, or whether it represents the administration's main thrust in economic development for the next several years. The designation of a maximum of 75 neighborhoods over the next 3 years is almost too big to be a demonstration; yet, in my opinion, it is far too small, given the number of truly distressed areas that exist.

The requirements for designation do not account for the development potential of an area, and they are also, I would think, rather biased against rural areas for a number of reasons, not the least of which is the resources. You see in the city of Baltimore's presentation that rural areas, unless supported strongly by the resources of the State, will have to submit a competitive proposal.

Senator **Chafee**. I think that, but also I think that the Secretary will probably have in mind, "Look, I have got to give x number to rural areas or there will be complaints."

Mr. **Revzan**. Yes. I think when the regulations are published for review. Is that what you meant?

Senator **Chafee**. No, I think as a practical matter, when he makes his decisions, he will say, "Look, I can't give them all to urban areas."

Mr. **Revzan**. In the area of regulatory flexibility and local government commitment, the area of deregulation, in reviewing some of those specific administration proposals, for example, elimination of State usury laws, it strikes me that these ideas have not been fully developed and may raise more questions than they answer at this time. Their implementation, in addition, is clearly not cost-free either to the States and local areas preparing applications or to Federal agencies that will have to address several types of requests of varying types to provide the regulatory relief that is requested in approved enterprise zones.

I would recommend, again, that a more specific set of guidelines be provided in the legislation addressing these issues.

As a final point, I think one area that has been overlooked in the legislation that again will be important, and it has been important in the past to the cities that have been most successful, is the role played by State and local government personnel employees that have been hired over the last several years with the assistance of and in many cases directly by Federal grants. They have hired individuals who are experienced in the development business, who are trained in finance and who are trained in packaging and in putting proposals together. I think that has paid off in the last few years in the types of programs we have seen, particularly in such areas as the UDAG program. And I think the Federal Government needs to continue its active participation in these efforts.

I appreciate the opportunity to testify and will be available for questions.

Senator CHAFEE. All right, fine. I will hold the questions until we finish the panel.

Dr. Butler?

STATEMENT OF DR. STUART BUTLER, SENIOR FELLOW, NATIONAL CENTER FOR NEIGHBORHOOD ENTERPRISE, WASHINGTON, D.C.

Dr. BUTLER. Thank you very much, Mr. Chairman, for possibility of testifying before you again. If we had Dr. Birch, I think we would have a full team to speak for you.

I want to concentrate on what I think are the main defects of the administration plan that is before us. But I do believe that the plan is a very significant step forward in developing the enterprise zone.

I think, in particular, the emphasis on seeing the zones as a net addition to the national economy and, hence, looking at new, small, and locally owned businesses is a very important element in the administration approach.

I think also the importance of the competition between cities, and the local commitment, is properly emphasized. I disagree with some of the previous witnesses. I believe that the streamlining of local regulations, particularly the speed of processing of permits and similar kinds of regulations, is a very important element in small business startups.

We should also recognize that, just as infrastructure is absolutely necessary in these zones, what you might call the "social infrastructure" is also important: the level of civility. I think the role of local deregulation is extremely important in that regard. We find dramatic successes registered by neighborhood-based organizations in dealing with the crime problem, for instance. And many of those organizations find local zoning, building codes and occupational licensing regulations to be a severe impediment. So in looking at local plans due regard should be paid to regulations that inhibit those community organizations as well as small businesses.

If we look at the tax mechanism, which I think is the area for greatest concern in the administration plan, it has been emphasized that nonrefundable tax credits are not very effective at dealing with the problems of totally new small startup businesses, for various reasons mentioned already. I think it is rather ironic that in many ways the ideal business, the very new small startup business from the neighborhood that may not be making a profit for some time, really cannot use any of the significant labor or capital incentives in the plan. I think it's rather sad that that's the case. I know that nonrefundability is considered to be necessary by the White House but I think it is clearly a defect of the program.

It has been made very clear by small businesses that the issue of startup capital is crucial to the success of the enterprise zone. I know that the plan does include the elimination of capital gains tax and the wider use of industrial development bonds in the zones, but I think the track record of businesses shows that these are very limited in their effectiveness at getting totally new types of businesses started.

We find, generally speaking, that capital for these small businesses tends to come from small investors, not major institutional investors, and that these small investors tend to be much more influenced by an immediate up-front tax benefit—I think Mr. Norris emphasized this—rather than the prospect of some tax relief way down the road, especially in high-risk areas with high-risk businesses.

So I share the view of some of the other witnesses that we should experiment with an investor-incentive which allows to a 100-percent writeoff of the investment in a new small business in an enterprise zone.

Given that we are talking about an incentive that relates to startup, not the general operation of a business, it's something that could be added to the zone for maybe 3 or 4 years. It would not necessarily have to go through the entire period of the zone. I think we can limit the amount of that writeoff for an individual investor, perhaps $25,000 to $30,000 per year, and there could be a requirement that the investment must be held for a minimum period, to reduce the possibility of loopholes.

I know Paul Pryde has a specific model that he will introduce to you.

I would just finalize by commenting that in Britain there is now a mechanism to encourage small business startups, quite unrelated to their enterprise zone plan, which might bear on this issue. In that plan, which allows an immediate writeoff in the first year of up to $20,000 providing the business is less than 3 years old, there are certain restrictions that might be necessary in looking at a similar plan here. For example, it only applies to businesses that are providing tangible goods and services; in other words, not businesses engaged primarily in financial transactions.

In order to be eligible, a business must also be what is called a new trade. In other words, it must not just be a purchase of an existing business, or a subsidiary established as a separate business. There is also a restriction on the eligible investors They must not be closely associated with the business, to avoid various churning possibilities, if they are to get tax relief.

So I think that the Treasury's opposition to this is unfortunate. By limiting the size of this kind of investment incentive and by putting on these kinds of limitations that I suggested we can have the maximum effect, the maximum boost to small businesses, without incurring any substantial revenue loss to the Treasury.

Senator CHAFEE. All right.

I think those restrictions you say, on page 10, that the British have seem rather rough. You don't permit an employee or a director, or anyone associated—I think those would be just the kind of people that would put their money in. But, never mind.

Mr. Paul Pryde, why don't you proceed?

STATEMENT OF PAUL L. PRYDE, JR., PRESIDENT, JANUS ASSOCIATES

Mr. **Pryde**. Thank you, Mr. Chairman. It's good to be here again. I will come straight to the point. Like so many others who have testified here today, I am interested in ways of getting venture capital invested in small young firms. And, as Mr. Norris did, and as Stuart does, I support the idea of an immediate writeoff for investments in such firms.

I do have a specific proposal, which is attached, and I would like to summarize that proposal for you.

What I would propose is that there be created a new type of financing instrument for small firms located in enterprise zones, which I would call, for purposes of discussion, enterprise stock and debentures. Investors in these debentures or stock issues would be entitled to write off 100 percent of that investment in the year in which the investment is made.

Companies qualified to issue these instruments—qualifying companies, that is—would be those which had a net worth of not more than $10 million including the amount of the issue, and which, as Stuart points out, would receive more than half of their revenue from other than passive sources. This is to avoid certain abuses such as might otherwise occur.

What I am suggesting is somewhat similar to a provision of existing law, the treatment of what is called section 1244 stock. Section 1244 stock is common stock issued by a domestic corporation which has a net worth not exceeding $1 million and which gets most of its income from active sources.

The Treasury now allows investors in such stock, when a loss occurs, to deduct that loss as an ordinary loss, up to a certain limit. Allowing an immediate loss deduction rather than a deferred deduction in the case of a loss would do two important things. One, it would create, to use a tainted term in these days, a "safe harbor" for certain purchases. That is, people would know that stock purchased under these conditions would entitle them to an immediate loss deduction. And, more importantly, it would increase the value of tax savings, since dollars earned to save today are more valuable than dollars earned to save tomorrow.

To discourage certain types of tax-avoidance abuses, I would say there would be a holding period of such stock of let's say 3 years. Any sales occurring within that time would be taxed at ordinary income rates; thus, the taxpayer would have to give back, perhaps with interest, all of the deduction he had earned or had taken previously.

I would like to talk about two effects, one on the Treasury and one on the investor himself or herself.

From the point of view of the investor, right now the elimination of capital gains taxes, as proposed, would increase the yield from a $10,000 investment which tripled its value over a 5-year period from 21½ percent to 24½ percent. The proposed largesse advance would increase that yield to 33 percent.

Likewise, you would get dramatic results in the case of an enterprise debenture. An investor in the 50-percent tax bracket who purchased a $10,000 10-year debenture from a qualifying firm would only have to charge the interest rate of 10 percent to get a yield of 17 percent. And that's not bad.

Mr. Chapoton said that this proposal would cost the Treasury a lot of money. I don't agree with that assessment. I have run some numbers which show that in order for the Treasury to actually lose money, about 90 percent of the firms issuing enterprise pocket debentures would have to fail. The reason for this is this: If you assume that a group of investors, for example, puts a million dollars into a group of 10 firms, and 2 of those firms succeed, their subsequent payments of corporate income tax will more than offset, with a return, in my judgment, the initial drop in revenue incurred by the 8 firms failing.

I will stop right now. As I said, there is a question and answer sheet as well as my attempt at legislative draftsmanship included as appendices to my statement.

Senator CHAFEE. Well, that is an interesting proposition. I think the testimony of all three of you addressed the problem of financing. I know that Dr. Butler felt that to get something upfront it means a lot more. Dr. Butler used the illustration of the IRA's that is a deduction right now.

So those are good points, and we appreciate you gentlemen testifying. Undoubtedly we will be talking with you more in the days ahead, as we try to iron this out.

Thank you, each of you, for coming.

[The prepared statements of the previous panel follow:]

STATEMENT OF LAWRENCE REVZAN, DIRECTOR, ECONOMIC DEVELOPMENT CONSULTING, COOPERS & LYBRAND

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I AM LAWRENCE REVZAN, DIRECTOR OF ECONOMIC DEVELOPMENT CONSULTING AT COOPERS & LYBRAND. MY BACKGROUND INCLUDES OVER TEN YEARS' CONSULTING IN ECONOMIC DEVELOPMENT FOR BOTH PUBLIC AND PRIVATE SECTOR CLIENTS. I ALSO SERVED AS DIRECTOR OF PROGRAM PLANNING FOR THE FEDERAL ECONOMIC DEVELOPMENT ADMINISTRATION FROM 1971 TO 1973. IN THE PAST YEAR I HAVE DONE CONSIDERABLE RESEARCH ON ENTERPRISE ZONES AND HAVE MADE PRESENTATIONS BEFORE SEVERAL GROUPS ON THE RELATIONSHIP BETWEEN ENTERPRISE ZONES, OVERALL ECONOMIC REVITALIZATION OF DISTRESSED AREAS, AND FEDERAL TAX POLICY.

IT IS MY DISTINCT PLEASURE TO BE HERE TODAY TO PRESENT MY OBSERVATIONS AND RECOMMENDATIONS ON "THE ENTERPRISE ZONE TAX ACT OF 1982," SENATE BILL 2298. WHILE COOPERS & LYBRAND HAS NOT TAKEN A FORMAL POSITION ON THE BILL, I WOULD LIKE TO PREFACE MY REMARKS ON THE BILL BY LISTING THE TYPES OF INITIATIVES WHICH I FEEL ARE VITAL TO THE SUCCESS OF ANY LEGISLATION DEALING WITH ECONOMICALLY DEPRESSED AREAS. MY OBSERVATIONS HAVE BEEN REINFORCED BY THE RESULTS OF UTILIZING COOPERS & LYBRAND'S "ENTERPRISE ZONE TAX IMPACT MODEL," DEVELOPED UNDER MY DIRECTION, TO ASSESS THE IMPACT OF THE PROPOSED INCENTIVES ON BUSINESS PERFORMANCE. I WILL DISCUSS THE MODEL IN GREATER DETAIL LATER IN THIS TESTIMONY.

THE SIX MOST IMPORTANT POINTS ARE AS FOLLOWS:

- FIRST, THE LEGISLATION MUST ADDRESS THE NEED FOR INFRASTRUCTURE DEVELOPMENT. WITHOUT ADEQUATE ROADS, UTILITIES, AND PREPARED SITES, IT IS UNLIKELY THAT SIGNIFICANT DEVELOPMENT CAN OCCUR IN DISTRESSED AREAS.

- SECOND, THE LEGISLATION MUST ADDRESS THE IMPORTANT ROLE OF SMALL BUSINESSES IN THE ECONOMIC REVITALIZATION OF DISTRESSED AREAS AND THEIR NEED FOR CAPITAL AT REASONABLE RATES AND UNDER FAVORABLE TERMS.

- THIRD, SO-CALLED "ENTERPRISE ZONES" MUST PROVIDE TAX INCENTIVES THAT HAVE A SIGNIFICANT DIFFERENTIAL IMPACT ON BUSINESS PERFORMANCE. THE "ECONOMIC RECOVERY TAX ACT OF 1981" PROVIDES FOR MANY OF THE SAME TYPES OF TAX INCENTIVES OFFERED IN ENTERPRISE ZONE LEGISLATION, WITHOUT IMPOSING ANY GEOGRAPHIC RESTRICTIONS ON INVESTMENT. TO HAVE ANY CHANCE OF PROVIDING A NET ADDITIONAL CONTRIBUTION TO THE ECONOMIES OF DISTRESSED AREAS, ENTERPRISE ZONE LEGISLATION MUST INCORPORATE SIGNIFICANT INCENTIVES TO PROSPECTIVE BUSINESSES AND INVESTORS TO PROVIDE A COMPARATIVE COST ADVANTAGE OVER ALTERNATIVE SITES.

- FOURTH, INCENTIVES SHOULD BE DIRECTED TO COST REDUCTION AND IMPROVED CASH FLOW OR "TOP-LINE MANAGEMENT" AS OPPOSED TO BOTTOM-LINE TAX REDUCTION MEASURES. INCENTIVES THAT REDUCE THE COST OF CAPITAL AND WAGE COSTS ARE MORE LIKELY TO BE EFFECTIVE THAN ADDED INVESTMENT TAX CREDITS AND TARGETED JOBS TAX CREDITS, BOTH OF WHICH THE SMALL BUSINESS MAY BE UNABLE TO USE.

- FIFTH, THE TYPES OF BUSINESSES TARGETED FOR THE PROGRAM SHOULD BE LABOR-INTENSIVE, BUT NOT NECESSARILY HIGH-TECHNOLOGY ORIENTED. RESEARCH INDICATES THAT DISTRESSED AREAS ARE MORE LIKELY TO BE ATTRACTIVE TO LABOR-INTENSIVE SMALL BUSINESSES SEEKING TO EXPAND THAN NEW, HIGH-TECHNOLOGY ORIENTED VENTURES OF A HIGH-RISK NATURE. THEREFORE, INCENTIVES SHOULD SPECIFICALLY FOCUS ON REDUCING THE COST OF LABOR, INCLUDING THE COST OF ABSORBING UNSKILLED WORKERS INTO ENTRY LEVEL JOBS.

- SIXTH, TO REALIZE LONG-TERM POTENTIAL FOR SUCCESS, ENTERPRISE ZONE DESIGNATION SHOULD BE SELECTIVE AND INCLUDE AREAS WITH A VARIETY OF CHARACTERISTICS SO THAT RESULTS, AND FACTORS CONTRIBUTING TO THOSE RESULTS, CAN BE CAREFULLY MONITORED.

I MADE THESE SAME POINTS LAST FALL IN TESTIMONY ON ENTERPRISE ZONE LEGISLATION BEFORE THE SUBCOMMITTEE ON TAX, ACCESS TO EQUITY CAPITAL AND BUSINESS OPPORTUNITIES OF THE HOUSE COMMITTEE ON SMALL BUSINESS. I BELIEVE THESE POINTS ARE STILL VALID TODAY, PARTICULARLY IN LIGHT OF FURTHER REDUCTIONS IN FEDERAL FUNDING FOR ECONOMIC DEVELOPMENT PROPOSED BY THE ADMINISTRATION IN FISCAL YEARS 1983 AND BEYOND, AND THE INCREASING RESPONSIBILITIES OF STATE AND LOCAL GOVERNMENTS, AS WELL AS THE PRIVATE SECTOR, IN THE DEVELOPMENT AREA.

LET ME NOW TURN TO SOME SPECIFIC COMMENTS REGARDING "THE ENTERPRISE ZONE TAX ACT OF 1982." I WOULD LIKE TO BEGIN WITH TITLE I OF THE BILL, "DESIGNATION:"

- FIRST, THE DESIGNATION OF 25 NEIGHBORHOODS OR SUB-NEIGHBORHOODS PER YEAR FOR THREE YEARS WILL LEAD TO THE CREATION OF, AT MOST, 75 ZONES BY JANUARY 1986, ALMOST FOUR YEARS FROM NOW. IF THE ENTERPRISE ZONE PROGRAM WERE EXPERIMENTAL, AS ITS ORIGINATORS HAD ENVISIONED, THIS NUMBER WOULD MAKE SENSE, OR PERHAPS EVEN BE TOO HIGH. IN LIGHT OF THE FACT THAT THIS PROGRAM HAS BECOME THE CORNERSTONE OF THE ADMINISTRATION'S ECONOMIC DEVELOPMENT PROGRAM, WITH SUCH AGENCIES AS EDA AND SBA EITHER BEING ELIMINATED OR SHARPLY CURTAILED, THE NUMBER OF ZONES TO BE DESIGNATED SHOULD BE RECONSIDERED AND POSSIBLY ENLARGED.

- SECOND, THE AREA REQUIREMENTS FOR DESIGNATION MAY BE INAPPROPRIATE IN THAT THEY PERTAIN TO THE RESIDENTIAL POPULATION AND DO NOT INDICATE THE POTENTIAL OF AN AREA FOR DEVELOPMENT. MORE APPROPRIATE CRITERIA MIGHT INCLUDE SUCH FACTORS AS THE AVAILABILITY OF FULLY IMPROVED INDUSTRIAL LAND AND/OR VACANT PROPERTIES THAT CAN BE REHABILITATED; THE LOCATION OF COMMERCIAL STRIPS; AND THE ACCESSIBILITY OF THE AREA TO TARGET POPULATIONS.

- THIRD, THE REQUIREMENTS OF PUTTING TOGETHER A COMPETITIVE ENTERPRISE ZONE PROPOSAL PLACE RURAL AREAS AT A SIGNIFICANT COMPETITIVE DISADVANTAGE TO URBAN AREAS THAT HAVE DEVELOPED A STRONG STAFF CAPABILITY IN ECONOMIC DEVELOPMENT OVER THE PAST SEVERAL YEARS. THE AREA REQUIREMENTS ARE TILTED IN FAVOR OF URBAN AREAS THROUGH THE ADOPTION OF UDAG CRITERIA. THERE ARE TWO WAYS TO OVERCOME THIS PROBLEM: (1) INDICATE IN THE LEGISLATION (OR LATER IN THE REGULATIONS) THAT A MINIMUM NUMBER OF RURAL AREAS, SAY 10, WILL BE DESIGNATED OVER THE NEXT THREE YEARS, USING APPROPRIATE SELECTION CRITERIA; (2) GIVE THE STATES A STRONGER ROLE IN THE NOMINATION PROCESS AND ENCOURAGE THE FULL CONSIDERATION OF SELECTED RURAL AREAS BY THE STATES.

- FOURTH, THE LENGTHY PERIOD OF DESIGNATION PROPOSED IN THE LEGISLATION HAS INADEQUATE CRITERIA PERTAINING TO ZONE PERFORMANCE, FOR EXAMPLE, NUMBER OF JOBS CREATED FOR THE DISADVANTAGED, DEGREE OF NEIGHBORHOOD FINANCIAL PARTICIPATION IN ZONE ACTIVITIES, AND SUCCESSFUL EFFORTS TO AVOID DISPLACEMENT. THE POTENTIAL REVOCATION OF DESIGNATION IS PROCESS-ORIENTED, RELATED TO THE DEGREE TO WHICH STATE AND LOCAL COMMITMENTS ARE MET. ZONE PERFORMANCE SHOULD BE CAREFULLY MONITORED AND DESIGNATION REVIEWED AFTER A PERIOD LONG ENOUGH (E.G., FIVE YEARS) FOR BUSINESSES TO REALIZE THE BOTTOM-LINE SAVINGS REQUIRED TO JUSTIFY THEIR INVESTMENT AND FOR COMMUNITIES TO IMPLEMENT THEIR ENTERPRISE ZONE PROGRAM INITIALLY PROPOSED.

A SECOND BROAD AREA UPON WHICH I WOULD LIKE TO COMMENT IS TITLE II, "FEDERAL INCOME TAX CREDITS." IN PREVIOUS TESTIMONY ON ENTERPRISE ZONE LEGISLATION, I INDICATED THAT THERE ARE TWO TYPES OF INCENTIVES NOT ADDRESSED IN THE "ECONOMIC RECOVERY TAX ACT OF 1981" THAT COULD BE EFFECTIVE IN STIMULATING INVESTMENT AND EMPLOYMENT IN DISTRESSED AREAS: TAX INCENTIVES TO INVESTORS (PARTICULARLY IN SMALL BUSINESSES) AND WAGE CREDITS TO STIMULATE EMPLOYMENT.

THERE ARE A NUMBER OF PROPOSALS THAT ADDRESS TAX INCENTIVES TO INVESTORS IN SMALL BUSINESSES. THESE INCLUDE AN INCOME TAX CREDIT FOR INVESTMENT IN ORIGINAL ISSUE STOCK, NONRECOGNITION OF THE GAINS FROM SALE OF ORIGINAL ISSUE STOCK (IF "ROLLED-OVER"), AND USE OF THE SMALL BUSINESS PARTICIPATING DEBENTURE. I FEEL THESE INCENTIVES COULD STIMULATE DIRECT INVESTMENT IN SMALL BUSINESSES AND WOULD COMPLEMENT SUCH EXISTING PROGRAMS AS SMALL BUSINESS INVESTMENT COMPANIES AND SBA SECTION 503 LOCAL DEVELOPMENT COMPANIES THAT SELL GOVERNMENT-GUARANTEED DEBENTURES TO FINANCE DIRECT LOANS TO SMALL BUSINESSES. WHILE THESE TYPES OF INCENTIVES WERE INCLUDED TO VARYING DEGREES IN PREVIOUSLY SUBMITTED ENTERPRISE ZONE BILLS, THEY ARE EXCLUDED FROM "THE ENTERPRISE ZONE ACT OF 1982." I FEEL THAT MEMBERS OF THIS COMMITTEE SHOULD REASSESS THE POTENTIAL EFFICACY OF SUCH INCENTIVES IN SATISFYING THE OBJECTIVES OF ENTERPRISE ZONE LEGISLATION.

IN THE AREA OF WAGE CREDITS, THE "ECONOMIC RECOVERY TAX ACT OF 1981" HAS EXTENDED THE USE OF TARGETED JOBS TAX CREDITS (TJTCS) THROUGH 1982 AND LIBERALIZED ELIGIBILITY CRITERIA. IF THESE CREDITS ARE TO BE USED, AND I QUESTION THEIR POTENTIAL EFFECTIVENESS BECAUSE OF THEIR LIMITED USE IN THE PAST, THEY SHOULD BE INCREASED ENOUGH SO THAT LOCATING IN AN ENTERPRISE ZONE WILL PROVIDE A SIGNIFICANT DIFFERENTIAL IN THE NET WAGE COSTS TO BUSINESSES. WHILE "THE ENTERPRISE ZONE TAX ACT OF 1982" HAS PROPOSED A COMPLEX, TWO-TIERED SYSTEM OF EMPLOYMENT TAX CREDITS, IT IS UNCLEAR WHETHER THE PROPOSED CREDITS ARE OF SIGNIFICANTLY GREATER VALUE TO BUSINESSES, AND LESS COMPLICATED TO USE, THAN TJTCS.

IN MY PREVIOUS TESTIMONY, I EMPHASIZED THAT, TO THE EXTENT THAT TAX CREDITS ARE UTILIZED, THEY SHOULD BE REFUNDABLE FOR SMALL BUSINESSES. OWNER-ENTREPRENEURS ARE MOST LIKELY TO RESPOND TO OPERATING COST SAVINGS. THEREFORE, IT WOULD BE MORE EFFECTIVE TO FOCUS ON DIRECT LABOR COST REDUCTIONS (FOR EXAMPLE, REDUCTION OF THE MIMIMUM WAGE), AND CAPITAL ACCESS/COST REDUCTIONS. IF INVESTMENT TAX CREDITS AND/OR TARGETED JOBS TAX CREDITS ARE INCREASED IN ZONES, THEY MUST BE MADE REFUNDABLE TO SMALL BUSINESS IF THEY ARE TO BE SUCCESSFUL BECAUSE THESE BUSINESSES GENERALLY DO NOT HAVE TAXABLE INCOME DURING INITIAL OPERATING YEARS. AN ALTERNATIVE APPROACH WOULD BE TO FACILITATE THE SALE OF UNUSED DEPRECIATION AND TAX CREDITS BY SMALL BUSINESSES UTILIZING ZONE MANAGEMENT ENTITIES AS FISCAL AND TRANSFER AGENTS, RATHER THAN RELYING SOLELY ON AN EXTENDED CARRY-FORWARD PROVISION AVAILABLE TO EACH BUSINESS INDIVIDUALLY.

THIS RAISES AN ADDITIONAL ISSUE REGARDING THE ATTRACTIVENESS OF VARIOUS TYPES OF EMPLOYMENT TRAINING PROGRAMS AND TAX INCENTIVE PROGRAMS TO SMALL BUSINESSES. ACCORDING TO A TASK FORCE REPORT ON ENTERPRISE ZONES ISSUED BY THE MINORITY BUSINESS DEVELOPMENT AGENCY (MBDA), "SMALL BUSINESS OWNERS ARE HESITANT TO ACCEPT LARGE NUMBERS OF UNTRAINED WORKERS EVEN THOUGH THEY SUPPORT THE JOB CREATION GOALS OF THE (ENTERPRISE ZONE) LEGISLATION." REPRESENTATIVES OF SMALL BUSINESSES ALSO INDICATED THAT "LABOR SKILL REQUIREMENTS AND TRAINING COSTS DIFFER SIGNIFICANTLY AMONG FIRMS AND INDUSTRIES." A TRAINING VOUCHER PROVIDED TO ELIGIBLE TARGET AREA RESIDENTS TO BE USED TO "PURCHASE" ON-THE-JOB TRAINING WAS CONSIDERED TO BE A POTENTIALLY MORE EFFECTIVE INCENTIVE FOR BUSINESSES TO HIRE UNSKILLED, DISADVANTAGED WORKERS THAN RELIANCE ON TAX CREDITS. ACCORDING TO BUSINESS ASSOCIATIONS, THE COSTS OF TRAINING HIGHLY SKILLED WORKERS CAN EXCEED THE PRESENT DISCOUNTED VALUE OF THE PROPOSED WAGE CREDITS SIGNIFICANTLY.

REPRESENTATIVES KEMP, GARCIA AND GRAY HAVE RESPONDED TO THE CONCERN OVER EMPLOYMENT TRAINING BY INTRODUCING H.R.5527, THE "PRIVATE SECTOR OPPORTUNITIES ACT," AS A COMPANION BILL TO THE ENTERPRISE ZONE LEGISLATION. THIS BILL WOULD AMEND TITLE VII OF THE COMPREHENSIVE EMPLOYMENT AND TRAINING ACT (CETA) TO DIRECT EFFORTS OF PRIVATE INDUSTRY COUNCILS (PICS) TOWARD MATCHING TRAINING PROGRAMS WITH THE NEEDS OF TARGET AREA BUSINESSES, AND TO INCREASE REPRESENTATION OF NEIGHBORHOOD GROUPS AND SMALL BUSINESSES ON THE PICS.

IT SEEMS CLEAR FROM AVAILABLE EVIDENCE ON THE EFFECTIVENESS OF THE TJTC PROGRAM, THE FINDINGS OF THE MBDA TASK FORCE, AND INFORMATION MADE AVAILABLE TO THE SPONSORS OF H.R.5527 THAT TAX CREDITS ALONE WITHOUT A COMPANION EFFORT TO ENHANCE THE SUPPLY OF LABOR WILL NEITHER ADDRESS THE SPECIFIC NEEDS OF SMALL BUSINESSES NOR IMPACT THE YOUTH AND RELATED UNEMPLOYMENT PROBLEMS OF INNER-CITY AND RURAL AREAS SIGNIFICANTLY.

A THIRD AREA UPON WHICH I WOULD LIKE TO COMMENT IS TITLE IV, "ESTABLISHMENT OF FOREIGN TRADE ZONES IN ENTERPRISE ZONES." WHILE I CONCUR WITH THE INTENT OF THE LEGISLATION THAT A COMBINED FOREIGN TRADE (OR EXPORT PROCESSING) - ENTERPRISE ZONE HAS INTUITIVE APPEAL, LITTLE IS KNOWN ABOUT THE TRACK RECORD OF FOREIGN TRADE ZONES IN THE UNITED STATES AND UNDER WHAT SET OF CONDITIONS THEY HAVE SUCCEEDED. IN FACT, THE FOREIGN TRADE ZONE MANUAL RECENTLY COMPILED BY FREE ZONE AUTHORITY SERVICES, INC., INDICATES THAT ONLY 38 OF THE 69 FOREIGN TRADE ZONES DESIGNATED TO DATE ARE OPERATIONAL, AND THE MAJORITY ARE PUBLICLY SUBSIDIZED. THE ENTERPRISE ZONE APPLICANT THAT WISHES TO COMBINE THE TWO ZONES IN SOME FASHION SHOULD BE REQUIRED TO PREPARE A FEASIBILITY STUDY INDICATING WHY THE PROPOSAL IS JUSTIFIED ECONOMICALLY AND FINANCIALLY IN ORDER TO RECEIVE APPROVAL. THE FACT THAT TWO AGENCIES, HUD AND COMMERCE, WILL BE INVOLVED WILL REQUIRE CLOSE COORDINATION, PARTICULARLY IN LIGHT OF THE LIMITED STAFF CAPACITY OF THE FOREIGN TRADE ZONE BOARD AT PRESENT.

A FINAL AREA UPON WHICH I WOULD LIKE TO COMMENT INCLUDES THE REQUIRED STATE AND LOCAL GOVERNMENT COMMITMENT (TITLE I) AND REGULATORY FLEXIBILITY (TITLE III). IN REVIEWING THE PROPOSED LEGISLATION AND THE ADMINISTRATION'S ACCOMPANYING NARRATIVE, IT IS CLEAR THAT POLICY-MAKERS AT HUD AND IN THE WHITE HOUSE VIEW THESE AREAS AS BEING POTENTIALLY MORE IMPORTANT TO THE SUCCESS OR FAILURE OF ENTERPRISE ZONES THAN THE TAX INCENTIVES PROPOSED IN TITLE II. HOWEVER, IN REVIEWING SUPPORT MATERIALS FOR THE PROPOSALS (E.G., STATE MODIFICATION OF OCCUPATIONAL LICENSURE LAWS AND USURY LAWS; STATE AND LOCAL REQUESTS TO SELECTED FEDERAL REGULATORY BODIES TO RELAX OR ELIMINATE PARTICULAR REGULATIONS WITHIN A ZONE), IT STRIKES ME THAT THESE IDEAS HAVE NOT BEEN FULLY DEVELOPED AND MAY RAISE MORE QUESTIONS THAN THEY ANSWER. THEIR IMPLEMENTATION IS CLEARLY NOT COST-FREE, EITHER TO THE STATES AND/OR LOCAL AREAS PREPARING APPLICATIONS, OR TO THE FEDERAL AGENCIES THAT WILL HAVE TO ADDRESS MYRIAD REQUESTS OF VARYING TYPES TO PROVIDE REGULATORY RELIEF IN APPROVED ENTERPRISE ZONES. I WOULD RECOMMEND THAT A MORE SPECIFIC SET OF GUIDELINES BE PROVIDED IN THE LEGISLATION BASED UPON AVAILABLE EVIDENCE OF AREAS IN WHICH BUSINESS COSTS, WITH AN EMPHASIS ON SMALL BUSINESSES, CAN IN FACT BE REDUCED.

I WOULD LIKE TO CONCLUDE BY REPORTING ON THE RESULTS OF RESEARCH CONDUCTED BY COOPERS & LYBRAND USING AN "ENTERPRISE ZONE IMPACT MODEL" MENTIONED AT THE OUTSET OF MY TESTIMONY. THE MODEL SIMULATES THE IMPACT OF APPLYING A VARIETY OF TAX INCENTIVE AND/OR COST REDUCTION PROGRAMS TO THE PROFIT AND LOSS STATEMENT OF A BUSINESS. THE BUSINESS CAN BE HYPOTHETICAL OR REAL, SMALL OR LARGE, NEW OR EXPANDING, AND OF ANY SIC CODE. THE MODEL IS PROGRAMMED TO ADDRESS THE IMPACT OF BOTH STATE AND LOCAL INCENTIVES, FOR EXAMPLE, REDUCED PROPERTY TAXES AND/OR INCOME TAX CREDITS, AND A WIDE VARIETY OF FEDERAL INCENTIVES OFFERED IN SENATE BILL 2298 AND PREVIOUSLY PROPOSED ENTERPRISE ZONE LEGISLATION.

IN A LIMITED SERIES OF APPLICATIONS (SMALL, EXPANDING MANUFACTURERS), OUR PRELIMINARY FINDINGS ARE AS FOLLOWS:

- FIRST, A BUSINESS CAN ADD SIGNIFICANTLY TO ITS CASH FLOW -- APPROXIMATELY 2 PERCENT PER YEAR ADJUSTED FOR INFLATION -- BY TAKING ADVANTAGE OF A STATE AND LOCAL INCENTIVE PACKAGE INCLUDING PROPERTY TAX ABATEMENT AND BELOW MARKET FINANCING.

- SECOND, IF STATE ENTERPRISE ZONE LEGISLATION PROVIDING INVESTMENT AND WAGE CREDITS IS ADDED TO EXISTING INCENTIVES, A LITTLE LESS THAN ONE PERCENT PER YEAR IS ADDED TO CASH FLOW, A RELATIVELY SMALL AMOUNT.

- THIRD, IF THE TYPES OF INCENTIVES PROPOSED IN SENATE BILL 2298 ARE PROVIDED WITHOUT ANY STATE AND LOCAL INCENTIVES, THEY HAVE APPROXIMATELY THE SAME IMPACT AS THE EXISTING INCENTIVE PACKAGE DESCRIBED ABOVE. IF THEY ARE ADDED TO EXISTING STATE AND LOCAL INCENTIVES AND PROPOSED STATE ENTERPRISE ZONE INCENTIVES, ONLY A SMALL AMOUNT (LESS THAN ONE PERCENT PER YEAR ADJUSTED FOR INFLATION) IS ADDED TO CASH FLOW.

- FOURTH, IN COMPARING THE PROVISIONS OF THE ADMINISTRATION PROPOSAL (SENATE BILL 2298) AND THE KEMP-GARCIA BILL, THE FORMER PROVIDES A MORE SIGNIFICANT IMPACT IN EARLY YEARS, BUT IT IS SURPASSED IN LATER YEARS AS THE 50 PERCENT GROSS RECEIPTS EXCLUSION FROM INCOME PROPOSED IN THE KEMP-GARCIA BILL BECOMES MORE IMPORTANT.

WE PLAN TO CONDUCT MORE ANALYSES WITH THE MODEL IN THE NEAR FUTURE AND WOULD BE HAPPY TO SHARE THE RESULTS WITH MEMBERS AND STAFF OF THIS SUBCOMMITTEE.

FINALLY, IT IS ALSO CRUCIAL TO CONSIDER THE ROLE PLAYED BY STATE AND LOCAL GOVERNMENT PERSONNEL IN STIMULATING INVESTMENT IN DISTRESSED AREAS OVER THE LAST SEVERAL YEARS. THE UNIQUE FORMS OF PUBLIC-PRIVATE PARTNERSHIP THAT HAVE EMERGED ARE PERHAPS AS SIGNIFICANT AS THE FINANCIAL INCENTIVES THAT HAVE BEEN OFFERED. THE FEDERAL GOVERNMENT NEEDS TO CONTINUE ITS ACTIVE PARTICIPATION IN THESE CAPACITY-BUILDING EFFORTS TO SUPPORT THE DEVELOPMENTAL OBJECTIVES THAT THIS LEGISLATION SEEKS TO ATTAIN.

I APPRECIATE THE OPPORTUNITY TO TESTIFY ON ENTERPRISE DEVELOPMENT LEGISLATION AND LOOK FORWARD TO WORKING WITH THE MEMBERS AND THE STAFF IN THE FUTURE. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS THAT MEMBERS OF THE SUBCOMMITTEE MAY HAVE.

* * * * * *

LAWRENCE REVZAN

Mr. Revzan directs the economic development and venture services group of Coopers & Lybrand and is based in Washington, D.C.

Mr. Revzan has been active in urban economic development for over a decade and served as Chief of Program Planning at the Federal Economic Development Administration in the early 1970s. Some of his most recent projects include: (1) preparation and implementation of local economic adjustment strategies, (2) evaluation of the Farmers' Home Administration Loan Guarantee Program, and (3) assessment of the role of state tax policy in economic development. He has recently made presentations on enterprise zones before such groups as the National Association of State Development Agencies and the Greater Baltimore Committee. His most recent article is entitled, "Enterprise Zones: Will They Affect Industrial Location Decisions?" and appeared in the Fall 1981 issue of *Industrial Development Magazine*.

Mr. Revzan holds a Master's Degree in Economics from the University of California at Los Angeles and has completed a special program in Real Estate Investment Analysis given by the Wharton School. He has been an active member of the National Council for Urban Economic Development since 1973 and is a member of several other professional organizations.

TESTIMONY PRESENTED BY DR. STUART M. BUTLER, SENIOR FELLOW, NATIONAL CENTER FOR NEIGHBORHOOD ENTERPRISE

STATEMENT

The views I express are my own, and do not necessarily represent those of the National Center for Neighborhood Enterprise, where I am currently in residence.

The President's enterprise zone proposal is a welcome step forward on the road to successful enteprise zones in America's inner cities. It is a comprehensive plan, which recognizes that the revitalization of depressed urban areas must involve several components. Tax relief, though important, is but one of these. Probably more important is a genuine attempt by all levels of government to encourage neighborhood service and business enterprises by reducing regulatory barriers and by contracting with non-professional organizations on a commercial basis.

In judging the details of the plan, it is important to remember the essential features of the enteprise zone concept:

* The enterprise zone concept rests on the assumption that within even highly depressed communities there is enormous potential, rendered dormant by a tax and regulatory system that suffocates initiative in high-risk areas. By creating a climate conducive to enterprise the zones can turn this dormant strength into active businesses and service providers.

It follows that the enterprise zone plan should be designed to stimulate the creation of new firms. From a national point of view it would be difficult to justify a program which merely brought about the relocation of businesses and jobs from one area to another. Consequently, the tax and other mechanisms in the plan must focus on new enterprises.

- The enterprise zone should foster adaption and innovation by businesses, service providers and government in the inner cities. Much of the distress in large urban areas can be attributed to a climate that has discouraged change. Innovation will occur more readily if we encourage the creation of many small firms -- countless studies have shown that the efforts of many small companies are more likely to discover the appropriate goods and services for a neighborhood than those of one or two major firms. Similarly, neighborhood-based organizations have scored stunning successes in dealing with social problems in depressed areas by the use of unorthodox approaches.

- Local ownership of businesses is almost as important to revitalization as the creation of jobs. A strong local business community stabilizes a neighborhood and provides positive role models for younger residents. Local business owners are also better able to gain the trust and cooperation of residents, for their mutual benefit, than owners who reside elsewhere.

If it is to be successful, therefore, the enterprise zone program must reduce the barriers to creativity in the inner cities, and provide tax incentives which will lead primarily to the formation of new, small firms.

The Administration plan is likely to be effective in meeting the goal of barrier reduction. By making the designation process competitive, there will be an incentive for cities to play their role in identifying needless red tape at the local level. The uncertainty that accompanies a competition is essential for the encouragement of genuine cooperation at the local level. We can see already that a limit on the number of designations will be beneficial because of the attendant competition. Cities that feel they will obtain a designation as of right, such as New York, show far less determination to reduce local barriers than others which feel they must make a good case to be chosen.

Judging applications will necessarily pose problems. The plan gives only broad guidance, and this is the best approach. Given the experimental nature of the program, and the desire to stimulate creative plans at the local level, it would be counterproductive to lay down precise requirements. If the experimental program proves a success, and certain local plans appear to be a better basis for an enterprise zone than others, then it might be sensible to provide more detailed requirements for a general program. But in the current plan maximum flexibility is needed.

The broad guidance in the plan correctly emphasizes the importance of neighborhood organizations and the privatization of services. In giving priority to applications, these features should rank above tax relief, because the strengthening of neighborhood groups and encouragement of alternative services is such a central element of the enterprise zone concept.

The Administration should pick a range of sites when making its final selection. In keeping with the experimental nature of the program, small cities and a wide geographical spread should be included. It may turn out that an enteprise zone causes a small improvement in a large blighted city, but yields a significant improvement in a small town. We may find also that zones will work better with one mix of land use than another. It is important to discover this, and that can only be done if a wide range of sites is chosen. In addition, a mechanism to monitor the results of the experiment should be included in the legislation, so that the full impact of sample zones can be evaluated.

The chief deficiency of the Administration plan involves the tax incentives. If the thrust of the approach is to generate new business activity which adds to the national economy, rather than simply attracting existing firms into the zones, the incentives must have a distinct character. They must appeal mainly to small, local, start-up firms, rather than to the location decisions of larger companies. Not only does this make sense in the context of the enterprise zone concept, but also in light of the evidence available on location decisions. We know from the experience of state tax incentives that tax breakes are not an effective method of influencing site decisions. On the other hand, as the October 1981 study by the Joint Economic Committee pointed out ("State and Local Economic Development Strategy: A 'Supply Side' Perspective"), changes in the tax law designed to increase work and investment within a geographic area can achieve impressive results.

The tax incentives in the plan seem to be inconsistent with the objectives of the concept and the Administration's position that the emphasis must be on genuinely new business development and new firms. The main incentives are tax credits for an expansion of a company's workforce and for the hiring of disadvantaged workers, together with an improved investment tax credit. The problem is that most new, small firms pay very little tax. Surveys by the National Federation of Independent Business and others show that federal income tax is well down the list of barriers to new business creation. Providing tax credits, deductible only from income taxes (and not the payroll taxes that even loss-making firms must pay), will be of little benefit to the very firms that the enterprise zone should seek to encourage. Ironically, the package as now constructed would mean that a profitable firm which uprooted and moved to the zone could face lower labor costs, since it could use the credits, than an "ideal" new, small, and locally-owned business. In addition, an unintended consequence of the strong credit for disadvantaged employees, which is available for new workers even if there is no increase in the total workforce, may be that companies already in a zone will fire local employees who have struggled to obtain some skills in favor of others who are classed as disadvantaged. This would be unfortunate, and very discouraging for local workers who come from families which have sought to maintain a stable environment. To reduce this effect, the legislation should be amended either to provide the disadvantaged worker credit only to additional employees, or to allow firms to take the general employment credit for existing workers.

Small business organizations have so far been unenthusiastic about the enteprise zone proposal because they have seen little which meets the main obstacle to new firm creation -- the acquisition of start-up capital. The Administration plan offers some modest help, but it needs to be strengthened considerably if it is to lead to significant risk-taking in the inner cities. The bill does eliminate capital gains tax on business property, and that will help. But the legislation restricts this to businesses which have been operating in the zone for at least three years; and it must also be seen in the context of the 1981 reductions in capital gains tax. It is unlikely that the present value of tax relief on the possible gain associated with an investment in a high-risk inner city firm would be sufficient to stimulate a significant flow of capital to enterprise zone companies.

Similarly, the availability of industrial development bonds within the enterprise zones is unlikely to address the capital acquisition problem adequately. The traditional sponsors of small, high-risk firms are not major lending institutions but rather small investors.

It is clear that the enterprise zone plan will not be complete until an effective mechanism to encourage investment in enterprise zone firms has been added to the legislation. Such a mechanism should be aimed not at large institutional lender, who rarely fund new small companies because of the risk involved, but instead at the small investor.

In recent years we have learned an important thing about these small investors. Stated simply, it is that they prefer a bird in the hand to two in the bush. People are quite willing to gamble on the capital value of a house in a marginal neighborhood, for example, because the can deduct the mortgage interest now. Similarly, there has been no shortage of people willing to lock away $2,000 a year in an IRA, where they gamble that their marginal tax rates in thirty or forty years time will be lower than now (a high risk indeed!), because the money can be deducted from taxes now. If the present value of an incentive is significant, people seem willing to take a considerable risk.

We should apply this phenomenon to the problem of capital for enterprise zone firms. Broadly, the IRS should allow an investor in an enterprise zone firm to deduct the entire loan or investment from his taxable income (subject to a maximum deduction of, say, $25,000), providing the money is kept in the business for a minimum period, say three years.

Suggestions have been put forward regarding particular provisions that could accomplish this with the minimum of problems and side effects. Paul Pryde, of Janus Associates, suggests that Section 1244 stock regulations be altered to allow the stock to be counted as a loss in the year of purchase. 1244 stock can be offered only by companies with a net worth of less than $1 million, and so there is an automatic size restriction. Pryde has also suggested that the deduction be extended to debt capital as well as stock, by allowing certain participating debentures to be treated in the same way.

The British have an experimental program in place which might also provide a suitable model. Under their plan, launched last year and covering the entire country, an investor may deduct up to $20,000 each year (changed in the latest budget to $40,000) from his taxable personal income for purchases of ordinary stock in a company not more than five years old, providing the stock is held for at least five years.

Certain important restrictions apply in the British case, and some of these should be incorporated here. But it must be remembered that the British plan covers firms anywhere in the country, and so fewer safeguards would be needed for firms in depressed areas.

Under the British plan, a company must meet certain eligibility requirments. It must produce tangible goods and services, and not be a financial company. In addition, it must be a "new" trade -- it must not, in other words, be a firm which is merely created out of an existing business, or one which has purchased a going concern. This restriction is necessary to prevent an existing company reincorporating to become a "new" firm and so have the right to offer the deduction to investors.

The British also impose certain restrictions on the investor. He or she must be neither an employee, a director, or in any other way associated with the firm; nor can the investor hold more than a 30 percent interest in the company. If the investor sells the stock before the five-year holding period, he must repay a portion of the tax relief.

A mechanism of this kind would be a crucial addition to the enterprise zone tax package. Since it is designed to deal only with the start-up capital issue, it could be operated for a three or four year trial period to test its effectiveness. To ensure that it would not be grossly misused, a restriction could be placed on the total amount of stock and/or debt that an enterprise zone company could offer to investors under the plan. If part of the deduction could be recaptured if the stock were to be sold (or the debt repaid) before the minimum holding period, it would also discourage misuse of the mechanism.

The inclusion of an investor incentive of the kind described would complete the enterprise zone tax package by stimulating the formation of new, small companies which could grow and eventually take advantage of the tax credits also available in the plan. It is an essential ingredient to complement the current tax and regulatory provisions of the bill.

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Stuart Butler

THE ENTERPRISE ZONE TAX ACT OF 1982: THE ADMINISTRATION PLAN

INTRODUCTION

The Administration's enterprise zone proposal, unveiled by Ronald Reagan on March 23, promises to break the logjam that has built up in Washington on the concept. While several states have passed their own versions of the enterprise zone and many cities have been pressing Washington to enact a program, congressional supporters of the idea have been frustrated by the absence of a concrete Administration plan, despite Reagan's long-professed enthusiasm for the innovation.[1]

Several bills were introduced last year but not acted upon. Commanding the widest interest and support was the Urban Jobs and Enterprise Zone Act (H.R. 3824, S. 1310), introduced in the House by Jack Kemp (R-NY) and Robert Garcia (D-NY), and in the Senate by John Chafee (R-RI) Rudy Boschwitz (R-MINN).[2] Other versions included bills introduced by Senators John Heinz (R-PA) and Donald Riegle (D-MI) (S. 1240), Senator John Danforth (R-MO) (S. 1829), and Representatives Henry Nowak (D-NY) (H.R. 2965), Charles Rangel (D-NY) (H.R. 2950), and Wes Watkins (D-OK) (H.R. 4576).

The Administration plan is the culmination of protracted discussions, chiefly between the Departments of Housing and Urban Development and Treasury. Its slow progress was due in large part to disputes between these two departments; HUD pressed for a bold approach and Treasury, skeptical of the concept's promised

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[1] For the history and development of the enterprise zone concept, see Stuart Butler, Enterprise Zones: Greenlining the Inner Cities (New York: Universe Books, 1981).

[2] For an analysis see Stuart Butler, "The Urban Jobs and Enterprise Zone Act of 1981," Heritage Foundation Issue Bulletin No. 68, July 16, 1981.

Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

payoffs and fearful of possible revenue losses, pushed for a weaker version. The President's plan draws mainly on HUD recommendations. Nevertheless, Treasury blocked some key tax elements, and this action threatens to reduce the program's effectiveness. Indeed, the whole program could be seriously weakened.

The President's plan, entitled The Enterprise Zone Tax Act of 1982, was introduced in the Senate by John Chafee and Rudy Boschwitz, who were chief Senate co-sponsors of the 1981 Kemp-Garcia bill, with John Heinz as the other principal co-sponsor. In the House, the legislation was introduced by Barber Conable (R-NY), ranking minority member on the Ways and Means Committee, William Stanton (R-OH), ranking minority member on Banking, Finance and Urban Affairs, Jack Kemp and Robert Garcia. It appears that most House and Senate co-sponsors of the Kemp-Garcia bill will co-sponsor the President's plan.

The bill will be referred to the House Ways and Means Committee and the Senate Finance Committee. At the time of writing, bill numbers had not been released, nor was it clear if the measure would also be referred to the House Banking, Finance and Urban Affairs Committee.

In submitting the bill to Congress, the President summarized the difference between the enterprise zone concept and earlier urban revitalization programs:

> The old approach relied on heavy government subsidies and central planning. A prime example was the Model Cities Program of the 1960's, which concentrated government programs, subsidies and regulations in specific, depressed areas. The Enterprise Zone approach would remove government barriers, freeing individuals to create, produce and earn their own wages and profits. In its basic thrust, Enterprise Zones are the direct opposite of the Model Cities Program of the 1960's.

He noted that the zones will not require appropriations at the federal level, other than for administrative expenses, and that in the spirit of New Federalism, state and local governments will have broad flexibility to develop contributions to their zones most suitable to local conditions and preferences.

THE ADMINISTRATION PLAN

The Administration's plan is designed to stimulate new economic activity in depressed inner city areas by creating a climate conducive to enterprise. Barriers to business are to be removed and tax incentives used to encourage risk taking and job generation. The plan calls for no grants or direct federal involvement in the development process.

The intent is to spur economic activity within the zones that would not otherwise have occurred in any other location. In short, the zones should stimulate the dormant potential of the selected neighborhoods rather than merely prompt existing businesses and jobs to move to the inner cities.

Like the 1981 Kemp-Garcia bill, the Reagan plan leaves it up to cities and states to initiate the enterprise zone concept. They must cooperate in developing a package of local incentives, to which the federal incentives will be added. Any detailed planning and expenditures within the zones are to be undertaken by the state and local governments.

1) Eligibility

Eligibility criteria essentially are those of the earlier Kemp-Garcia proposal. The targeted area must be suffering pervasive poverty, unemployment, and general distress and must satisfy the eligibility criteria of the Urban Development Action Grant program. The area must contain at least 4,000 residents, if it is within a city of 50,000 or more; if not, the area must have at least 2,500 inhabitants or be entirely within an Indian Reservation. In addition, it must satisfy at least one of the following requirements:

- Average unemployment of at least one and a half times the national average;
- A poverty rate of at least 20 percent for each census tract, minor civil division or census county as determined by the most recently available census data;
- At least 70 percent of the proposed zone's households with incomes below 80 percent of the residents in the jurisdiction of the government requesting the designation;
- At least a 20 percent drop in population between 1970 and 1980.

2) Designation

Areas meeting the eligibility criteria can be nominated for enterprise zone designation by cities, with the support of the state, but they will not qualify automatically for designation. The Secretary of HUD will select the zones. Upon designation, the federal tax incentives and regulatory relief described below will apply within the zones. The Secretary is limited to seventy-five designations over a three-year period. Exactly how long an area is to be an enterprise zone is a matter of negotiation, but the period cannot exceed twenty years plus a four-year phaseout.

The Secretary of HUD is to consider the merits of the applications in designating the enterprise zone. In this competitive process, the local package of incentives and deregulation proposed by the city and state will be important. Priority is to be given to those emphasizing:

- Tax relief;
- Regulatory relief;
- Improved public services, especially experiments with private sector providers;
- Involvement of neighborhood organizations and other private groups.

In addition to the level of distress in the proposed zone, the Secretary is to take into account the fiscal and constitutional restraints on the ability of the state or local government to grant tax relief. Consideration too is to be given to job training programs, investment commitments, and other proposals of the applicant.

The designation process is to be flexible. A local package weak in tax incentives, for instance, could be balanced by stronger local deregulation. If the state and local governments fail to meet their commitment, the designation later could be withdrawn. While zones can be designated in small towns, or even rural areas, it appears that the bulk of the zones, at least in the program's early years, will be in large urban areas.

3) Federal Tax Incentives

Investment Tax Credit

A bonus investment tax credit, in addition to that available to any American business, will be available for new plant and machinery in the enterprise zones. For property depreciable in three years, the credit will be 3 percent; for five-year property, it will be 5 percent. The construction or rehabilitation of commercial, industrial or rental housing structures would qualify for a 10 percent credit.

Capital Gains Tax

Capital gains tax is not to be levied on the sale of "qualified" property in the zones held for over twelve months.[3] This exemption also is to cover the first sale or exchange made after the zone designation ends.

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[3] Defined as any real or tangible property used predominantly for business purposes in an enterprise zone, or any interest in a company, providing that for at least three years the company was engaged in active zone business at least 80 percent of its revenues came from zone operations, and substantially all of its facilities were located in an enterprise zone.

Payroll Tax Credit

Employers will be allowed a non-refundable tax credit equal to 10 percent of the total payroll paid to "qualified" employees, in excess of the payroll paid to such employees in the year prior to the zone.[4] The credit is not to exceed 2.5 times the FUTA base wage for each qualified worker. This currently is $15,000, which would mean a maximum credit of $1,500 per worker.

A non-refundable credit will be available for qualified workers who are also disadvantaged (based largely on the CETA criteria) and hired after the zone designation. The credit is to be equal to 50 percent of wages paid in the first three years, declining by 10 percent of the wages in succeeding years. The general 10 percent credit would be added to this credit.

Employee's Tax Credit

"Qualified" zone employees will also be allowed an annual non-refundable personal income tax credit equal to 5 percent of taxable income earned in the zone, with a maximum based on 1.5 times the FUTA wage base (meaning a credit of up to $450).

4) Operating Loss Carryover

Enterprise zone firms will be allowed an operating loss carryover for the life of the zone plus the four-year phaseout period, up to twenty-four years, compared with the normal fifteen years. The carryover also is to apply to the tax credits.

5) Industrial Development Bonds

Industrial Development Bonds are to be retained and made more available to small firms in the zones, even if their use is curtailed elsewhere.

6) Foreign Trade Zones

The Foreign Trade Zone Board is to be instructed to authorize applications for the establishment of foreign trade zones in enterprise zones when practicable. The board will be instructed to expedite applications.

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[4] Defined as an employee who performs more than 50 percent of his services for an enterprise zone employer, with 90 percent of those services directly associated with zone activities. Making this and other credits non-refundable means that, if the credit exceeds the company's tax liability, the company will not receive a check from the Treasury. It can, however, carry over unused credits into succeeding years. Moreover, the credits cannot be applied against payroll taxes. In the case of a tax credit for individuals, non-refundability means that the credit is limited to the total tax liability of the taxpayer -- any excess is not sent to the individual.

7) Federal Regulation

Federal agencies are to have discretion to relax or eliminate regulatory requirements, while maintaining standards mandated by Congress, upon the request of the state and local governments with jurisdiction over a zone. The federal agency is not to act without such a request. This provision does not cover statutory regulations such as minimum wage.

In addition, the zones will be defined as "small entities" under the terms of the 1980 Regulatory Flexibility Act (P.L. 96-354).

ANALYSIS

Designation

The Administration's basic eligibility requirements are virtually the same as the Kemp-Garcia criteria. In the designation process, however, the Administration intends to give priority to cities that experiment with turning over services to the private sector and to those that involve neighborhood organizations in the enterprise zone process.

The important role that neighborhood groups play in controlling crime and improving social climate in depressed areas is well documented.[5] Unless these organizations work closely with businesses, it is unlikely that many firms will take advantage of even the most generous enterprise zone tax incentives. Not only do such formal and informal groups tend to be ignored by officials in many of the most blighted cities, but regulatory obstacles often are erected to curtail their activities. Zoning and licensing requirements, for example, have thwarted countless groups trying to provide daycare, security, and other essential services.

Given the importance of neighborhood organizations, HUD should insist that cities eliminate or reduce regulatory impediments to neighborhood groups in enterprise zones as a requirement for the designation.

Employment Incentives

The Administration proposal includes a stronger incentive to hire disadvantaged workers than Kemp-Garcia, and gives a credit for all newly hired workers. But certain restrictions on the credit could seriously reduce its effectiveness.

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[5] See Robert Woodson (ed.), Youth Crime and Urban Policy (Washington, D.C.: American Enterprise Institute, 1981).

The general employment credit is available only for additions to the payroll. A firm already in the zone will obtain credits only for new workers -- or for disadvantaged workers hired to replace current employees. Thus, existing firms will have an incentive to close down and reincorporate in order to become a "new" firm with "new" employees. They will also be rewarded, especially if they do not reincorporate, if they replace their less skilled personnel with disadvantaged workers. As a result, low-income workers who have struggled successfully to obtain a job and acquire basic skills might be displaced.

The credits in the Reagan plan are non-refundable, in contrast with the Kemp-Garcia credits. So they will be of little value to new, small companies, most of which earn little or no taxable income for several years. These businesses will not be able to use the credits to offset the Social Security payroll taxes which even loss-making firms must pay.

The Administration plan drops the Kemp-Garcia requirement that a business earmark 40 percent of new jobs for CETA eligibles before it can qualify for most enterprise zone tax incentives. Administration officials have argued persuasively that this would be a burden on small firms and would be difficult to enforce. In order to encourage the hiring of disadvantaged workers, the Administration therefore has decided to use an attractive tax incentive rather than a rigid requirement that would dissuade firms from locating in a zone.

Employee Incentives

The income tax credit for employees in zone firms is twice that of the Kemp-Garcia scheme. Like the business credits, it is non-refundable and will therefore be of limited benefit to low-income workers.

Business Incentives

Earlier drafts of the Administration plan restricted the elimination of capital gains on zone business property to businesses with no corporate shareholders. This restriction was intended to prevent corporations from transferring assets to a zone subsidiary to resell them and utilize the capital gains tax elimination. By removing this restriction in the final plan, the Administration evidently believes that the need to encourage corporations to provide start-up capital for new, independent zone firms outweighs possible revenue losses arising from asset transfers.

The Kemp-Garcia bill, on the other hand, provided for a tax allowance equal to 50 percent of the interest received by a taxpayer who provided capital for zone businesses. This was designed to remedy the capital shortage plaguing new companies, particularly in distressed neighborhoods. The Treasury has complained that the provision invites abuse. The Administration package replaces it with the investment tax credit (ITC) and industrial development bonds (IDBs). But the ITC is available only for investments in plant and machinery and is therefore of limited use to labor intensive firms. ITCs can be credited only against income tax, so the provision will not tend to help fledgling companies.

IDBs are a poor tool for financing new, small firms. The large, institutional lenders who use IDBs generally avoid small, risky companies, especially in depressed areas. Will they change their practices because IDBs are made more available? Unlikely. IDBs have been widely criticized, moreover, as susceptible to local politics and favoritism.

Regulation

For new businesses, federal regulation is usually less of a burden than local regulation, but federal rules do create problems. The Kemp-Garcia bill sought to remedy this in enterprise zones by applying to them the provisions of the 1980 Regulatory Flexibility Act, which allows for some discretion in rule making. The Administration enterprise zone proposal adds to this mechanism a provision that would enable an agency to alter non-statutory rules, but only if requested by the state and city. This means regulatory change cannot be effected without the agreement of all three levels of government. This requirement will probably mean that little federal deregulation will occur in the zones.

Earlier versions of the Administration's plan would have allowed cities and states to petition for a youth subminimum wage in a zone. Political pressure led to the removal of this provision from the final version. This is unfortunate. Many experts maintain that the minimum wage law prices young, unskilled people out of the labor market, and is a major cause of high unemployment in the inner cities. The Commerce Department's Minority Business Development Agency found strong support for this view among minority businessmen when it surveyed their views on the enterprise zone concept.[6] By eliminating the provision, the Administration has removed the possibility of cities testing the thesis that minimum wage laws are a significant factor in chronic youth unemployment.

Cost

The Treasury Department estimated that for a sample zone containing 10,000 employees the cost would be $12.4 million per year in terms of lost tax revenue. Based on this estimate, the tax loss associated with the program's target of twenty-five zones in the first year would be $310 million -- smaller than the annual expenditure under the Urban Development Action Grant program.

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[6] Minority Business Development Agency Task Force Report on the Impact of Enterprise Zones on Small and Minority Businesses (Washington, D.C.: U.S. Department of Commerce, 1981), p. 41.

But this is a worst case estimate, based on the assumption that virtually no new economic activity will be created that would not have occurred elsewhere. If the program is successful in generating genuinely new businesses and jobs, and reducing the welfare roles, the cost would be substantially less. Indeed, if the program resulted in a high proportion of genuinely new businesses and employment - and hence new taxpayers -- the zones could conceivably be revenue earners!

THE SPECIAL IMPORTANCE OF SMALL BUSINESS

The Administration insists that a primary aim of the plan is to generate new businesses, and new businesses mean small business. Fortune 500 companies grow from small concerns, they do not sprout overnight. Moreover, small firms are by far the most effective job-creators in the economy, accounting for virtually all the net new jobs in the northeast and most new jobs across the nation.[7]

Small firms are vital for other reasons. Development of a strong, local business community is an important ingredient in successful revitalization of depressed neighborhoods. Small entrepreneurs with a direct stake in the community strengthen the social fabric. Small companies are also the most innovative and adaptive firms, the most likely to develop those products and services best suited to their neighborhood. Large companies, on the other hand, are not significant job generators[8] and invariably dominate the neighborhood economy.

Despite the key role of small business in the enterprise zone concept, the Administration's proposal offers such firms almost nothing. Because most new companies do not usually show taxable profits for several years, tax credits are of little help. Indeed, the National Federation of Independent Business discovered in a recent survey of urban small businesses that taxes are well down on the list of problems faced by new companies. The biggest worry: start-up capital.[9] Eliminating the capital gains tax will provide only modest help in solving the capital shortage. The prospect of a small tax benefit at some future date, and then only if a zone business is successful, will hardly prompt investors to flock to inner cities.

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[7] David Birch, Job Creation in Cities (Cambridge, Massachusetts: MIT, 1980).

[8] Ibid.

[9] Report on Small Business in America's Cities (Washington, D.C.: NFIB, 1981), p. 12.

In short, the Administration's plan confronts new, small firms with a Catch-22 situation. To encourage new companies to form and grow, the plan offers credits against business taxes so that more money can be retained for expansion. But businesses must be successful and profitable before they will owe enough tax to benefit from the breaks designed to make them successful and profitable.

RECOMMENDATIONS

If the enterprise zones are to reach their full potential, the Administration's proposals should be modified in some basic areas.

Incentives to Investors

When small businessmen say taxes are unimportant to them as they start their ventures, they ignore the impact of taxes on the investor who might provide capital for the firm. It is clear from the history of IRA accounts, housing, wildcat oil drillings, and similar cases that Americans are prepared to invest in long-term or high risk ventures if they can enjoy an immediate tax break. This characteristic should be applied to enterprise zone plans. Investors in new, small zone firms should be permitted to deduct the entire investment from their taxable income (subject to a maximum of, say, $25,000 per taxpayer), providing the money is kept in the firm for a minimum period -- perhaps three years. This could produce a considerable flow of funds from individual investors -- the traditional backers of new ventures. Unlike the ITC, this proposal would provide general capital and would help labor-intensive companies. The total cost of the deduction to the Treasury would be small, because the investors would tend to be taxpayers who normally would shield their investments from taxation in any case. In fact, federal coffers would probably gain as job creation spawned new taxpayers and trimmed welfare outlays.

A provision of this kind was introduced recently in Britain as an experiment on the national level. Already it appears to be channeling capital to new ventures. It also has encouraged the creation of investment clubs operated by professional managers. These clubs pool and invest the money of many individuals. It is likely that granting tax deductions for enterprise zone investment in the U.S. would lead to the emergence of enterprise zone loan funds. Senator John Danforth (R-MO) included this notion in his Rural Enterprise Zone Act of 1981 (S. 1829).

Contributions to Neighborhood Organizations

Danforth's bill also provided a special tax credit to any taxpayer making a contribution to a tax-exempt neighborhood organization providing services in a zone[10] or to a community development corporation located in a zone. At the very least, enterprise zone legislation should remove federal taxation from state tax credits for contributions to these important neighborhood groups. Missouri and Pennsylvania are among the states that provide such credits.

Displacement

Whenever successful development takes place in a blighted community, property values tend to rise, new residents arrive, and many earlier residents with no direct stake in the development find themselves squeezed out of the neighborhood. Though the emphasis on local involvement and ownership in the enterprise zone concept should reduce this problem, means should be found to ensure that residents are the enterprise zone's primary beneficiaries.

In the designation process, priority could be given to local plans seeking to spread ownership in an enterprise zone. Such plans might include versions of homesteading or shopsteading. In addition, cities could be encouraged to give neighborhood organizations title to city-owned property, such as vacant lots and abandoned buildings. If enterprise zone land values were to increase, the organizations would then hold assets of rising value. They could derive an income from sales, or lease revenue could be used to benefit residents or provide new services. This would give neighborhood groups a financial incentive to work closely with business since both would gain from successful development.

The federal government could supplement such experiments by amending the IRS code pertaining to General Stock Ownership Corporations (GSOCs), to allow states to charter GSOCs within enterprise zones. An enterprise zone GSOC then would be a corporation consisting of all the zone's residents. It would engage in business activity, but would not be liable for corporate taxation if at least 50 percent of its profits were distributed to members. The federal government could stipulate that any state and city wishing to create an enterprise zone GSOC must provide the corporation with title to vacant city-owned property as a base for its acitivies. By ensuring this flow of benefits, the GSOC could provide extra income to low-income residents to offset rent increases and other costs that increase displacement. A bill to apply GSOCs to enterprise zones, in a similar way to this, is being prepared by Senator Gary Hart (D-CO).

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[10] That is, an organization described in Section 501(c)3 of the tax code as exempt under Section 501(a).

CONCLUSION

The President is strongly committed to the enterprise zone concept and shares the belief of mayors and inner city leaders that depressed neighborhoods possess considerable potential. As Reagan told the National Urban League during his presidential campaign:

> Those who view poverty and unemployment as permanent afflictions of our cities fail to understand how rapidly the poor can move up the ladder of success in our economy. But to move up the ladder, they must first get on it. And this is the concept behind enterprise zones.

The problem is that the Administration plan combines the best of intentions with an incomplete tax mechanism. By concentrating on tax credits rather than investor incentives, it will help profitable, taxpaying businesses rather than new, small businesses. It will, in short, tend to help those who are already on the ladder.

The emphasis on neighborhood participation is an extremely valuable part of the plan, however. Neighborhood organizations are the social entrepreneurs of the inner cities. To be effective in their efforts to combat crime and other problems, they need flexibility and government cooperation. The local package of action required in the designation process should strengthen such groups -- an objective of the President's call for increased voluntarism as well as of the enterprise zone.

A hidden danger in the plan is its complexity. The Treasury, true to tradition, has saddled almost every incentive with detailed restrictions and qualifications. It is unsettling that a measure intended to spread economic freedom and cut red tape in the inner cities occupies 79 pages and requires 28 single-spaced pages of official explanation. When regulations are eventually added to all this, the final product may become a consultant's dream and businessman's nightmare. Every effort must be made to simplify the language, or the incentives might be unobtainable by the very people for whom they were supposedly created.

The Administration's long-delayed plan clearly has some serious flaws, but they are correctable. The legislation is consistent with the President's view of federalism, and it will complement action already taken by several states and cities. With suitable improvement, particularly regarding small business incentives, it could provide the appropriate vehicle to unlock a new era of enterprise and creativity in our inner cities.

Prepared at the request o
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STATEMENT OF PAUL L. PRYDE, JR., PRESIDENT, JANUS ASSOCIATES

THE USE OF TAX INCENTIVES TO STIMULATE INVESTMENT IN ENTERPRISE ZONE FIRMS

My name is Paul Pryde. I am president of Janus Associates, a development consulting firm which specializes in small business and development finance problems. I want to thank you for the opportunity to present my views on the enterprise zone legislation now before this Committee.

As I am sure you have heard from many of the people who have appeared at these, as well as last July's, hearings, a principal aim of enterprise zones should be to overcome barriers to the expansion and formation of the young, small businesses which create most jobs. One of the most important of these barriers is the scarcity and high cost of financing, especially risk capital. It is this problem which I believe the Administration's proposal fails to address adequately and to which I want to address my comments today.

The rapid growth in Federal and state financing programs for small business has tended to obscure the fact that most new firms do not get most of their initial capital from government loan programs or other institutional sources. Rather, fledgling companies tend to obtain their risk money from the personal savings of the entrepreneur as well as from investments by friends, family members and business associates. Apparently realizing this fact, the Administration's bill would eliminate capital gains taxes on investments in enterprise zone firms. Unfortunately, this meausre, in my judgment, is unlikely to work as well as hoped to stimulate new business investment.

There are two reasons. The first is that the maximum capital gains rate is now quite low, only 20%. Reducing it further can produce only a small net change in an investment's after-tax return. The second is that a reduction in capital gains taxes represents future dollars, and money saved or earned tomorrow is simply worth less than money saved or earned today. Most investors will probably refuse to incur what they perceive to be the substantial added risks associated with investments in enterprise zone firms for small tax concessions on profits which they may or may not get.

For example, the after-tax return on a $10,000 stock investment held for five years and then sold for triple its cost would be 21.5% with the current capital gains tax, and only 24.5% with no capital gains tax at all.

What is needed instead of reductions in future taxes are incentives which will reward current risk taking with current tax savings. To accomplish this end, I would propose that purchasers of stock or debentures of qualifying companies -- let's call these instruments enterprise stock or debentures -- be permitted an immediate "ordinary loss" deduction in the amount of their investment. Qualified companies would be those with a net worth of not more than $10 million (including the enterprise stock or debentures) which receive at least half of their revenue from other than passive sources (rents, royalties, interest, and the like).

What I am suggesting is similar, in some respects, to the treatment of what is called "Section 1244" stock. Section 1244 stock is common stock issued by a domestic corporation which:

a. has a total net worth not exceeding $1,000,000 (including Section 1244 stock), and

b. obtains at least 50% of its gross receipts from sources other than royalties, rents, dividends, interest, annuities and sales and exchanges of stock.

The Internal Revenue Service currently permits investors in such stock, which later becomes worthless, to deduct the loss, up to a maximum of $50,000 for an individual, and $100,000 for a husband and wife filing jointly.

Allowing an immediate ordinary loss deduction for enterprise stock and debentures would offer investors two important benefits:

a. It would create a "safe harbor" for purchasers of such stock. The stock and debentures would be presumed, for tax purposes, to be immediately worthless and taxpayers would be assured that the IRS would not challenge ordinary loss deductions taken with respect to them.

b. More importantly, permitting investments to be taken as loss immediately would substantially increase the value of tax benefits attributable to ordinary loss treatment. That is, the taxpayer would realize his tax savings immediately rather than a few years later.

To discourage certain types of tax avoidance abuses, purchases of enterprise stock and debentures should be subject to a minimum holding period of, say, two or three years. Proceeds from sales or exchanges during this period would be taxed as ordinary income. Proceeds from the sale or exchange of enterprise stock and debentures beyond the minimum holding or recapture period would not be taxed at all.

You will recall that I estimated that a $10,000 stock investment which tripled its value in five years would, under current law, give a 21.5% after-tax return for a taxpayer in the b

50% bracket. The treatment I have recommended for enterprise stock would increase that taxpayer's return by over 50%, to 33%.

That same treatment would also produce dramatic results in the case of enterprise debentures. An investor in the 50% tax bracket who purchased a $10,000 10-year debenture from a qualifying firm would only have to charge an interest rate of 10% to achieve an after-tax return of 17%.

Let me now turn to the issue of cost. Some may think the change I have proposed will cost the Treasury a great deal of money. Not true.

Assume, for the moment, that a group of investors decides to invest a total of $1,000,000 in enterprise zone firms through the purchase of enterprise stock. The group selects ten different firms and invests $100,000 in each. Under my proposal, the members of the investment group would be entitled to $1,000,000 in ordinary loss deductions on their tax returns for that year, and the Treasury's revenues would be reduced by the amount of the group's tax savings, or $500,000. This drop in revenue should not be considered a loss for, as the attached appendix shows, if only two of the ten firms financed succeeds, the Treasury can still make money on its "investment" -- under the assumptions I have made, a return of about 15%.

I make no claims of expertise at legislative draftmanship. However, I have also included as an appendix an expression of the proposal in what I believe to be appropriate legislative language, and a set of questions and answers which address some of the key issues which it would appear to raise. I hope you find them useful in your deliberations on what I believe to be an important development initiative for distressed communities.

APPENDIX 1

Investment Analysis

Enterprise Stock

Year	Combined Earnings	Treasury Return (Investment)
1	0	(500,000)
2	0	-
3	0	-
4	0	-
5	0	-
6	200,000	50.000
7	240,000	60,000
8	288,000	72,000
9	346,000	86,000
10	415,000	104,000
11	498,000	124,000
12	597,000	149,000
13	717,000	179,000
14	860,000	215,000
15	1,032,000	258,000
16	1,238,000	310,000
17	1,486,000	372,000
18	1,783,000	446,000
19	2,140,000	535,000
20	2,568,000	642,000

Discounted rate of return 15.1%.

Notes to Appendix

The above analysis assumes:

(a) the two successful companies have no taxable income for five years;

(b) in the sixth year, each company reports taxable income of $100,000, or $200,000 for the two firms combined;

(c) in each succeeding year, earnings grow by 20% and are taxed at an average of 25%.

APPENDIX 2

TITLE II - FEDERAL INCOME TAX INCENTIVES

Subtitle G - Deduction for Purchasers of Enterprise Company Stock and Debentures

Sec. 271. ENTERPRISE STOCK AND DEBENTURES

Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gain and loss) is amended by adding at the end thereof the following new section:

"Sec. 1258. ORDINARY LOSS DEDUCTION FOR ENTERPRISE STOCK AND DEBENTURES.

"(a) In General.--For purposes of this subtitle amounts actually paid during the taxable year by a natural person or partnership of such persons, in respect to the purchase of enterrise stock or debentures shall be deductible for the purpose of determining taxable income for that year.

"(b) Maximum Amount for Any Taxable Year.--For any taxable year, the aggregate amount deducted by the taxpayer by reason of this section shall not exceed (1) $250,000 or (2) $500,000 in the case of a husband and wife filing a joint return for such year under Sec. 6013.

"(c) Rules for Purchases.--For purposes of this section purchases under subsection (a) shall be deemed to have made on the last day of a taxable year if the payment is on account of such taxable year and is made not later than the time prescribed by law for the filing of the return for such taxable year (including extensions thereof).

"(d) Enterprise Stock and Debentures.--In General.--

"(1) The term 'enterprise stock' means common stock issued by a qualified issuer.

"(2) The term 'enterprise debenture' means a written debt instrument issued by a qualified issuer which--

"(A) is a general obligation of the qualified issuer,

"(B) bears interest at a rate not less than the rate prescribed by the Secretary under section 483(c)(1)(B),

"(C) has a fixed maturity.

"(3) Qualified Issuer.--

"(A) In General.--The term 'qualified issuer' means a qualified business for the purposes of subsection 221(b)--

"(i) the net worth of which does not exceed $10,000,000 including enterprise stock or debentures,

"(ii) which has no securities outstanding which are subject to regulation by the Securities and Exchange Commission at the time of issuance of the enterprise stock or debentures,

"(iii) which during the period of its five most recent taxable years ending before the date on which enterprise stock or debentures were issued, derived more than 50 percent of its aggregate gross receipts from sources other than royalties, rents, dividends, interest annuities and sales and exchanges of stocks or securities.

"(B) Controlled Groups.--For purposes of determining under subparagraph (A) the net worth and outstanding enterprise stock or debentures of--

"(i) a member of the same controlled group of corporations (within the meaning of section 1563(a), except that 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears in section 1563(a)(1)), and

"(ii) a member of a group of trades or businesses which are under common control, as determined under regulations prescribed by the Secretary which are based on principles similar to the principles which apply under clause (i),

the net worth and outstanding enterprise stock or debentures of all members of such group shall be taken into account.

"(C) Security Subject to Regulation by the Securities and Exchange Commission.--For purposes of clause (e)(A)(ii), a security subject to regulation by the Securities and Exchange Commission is a security--

"(i) registered on a national securities exchange under section 12(b) of the Securities Exchange Act of 1934;

"(ii) registered or required to be registered under section 12(g) of such Act (or which would be required to be so registered except for the exemptions in subparagraphs (B) through (H) of such section); or

"(iii) issued by a company subject to the reporting requirements of section 15(g) of such Act.

"(e) Special Provisions.

"(1) Limitations on amount of deduction.--If

"(A) enterprise stock or debentures were issued in exchange for property,

"(B) the basis of such stock or debenture in the hands of the taxpayer is determined by reference to the basis in his hands of such property, and

"(C) the adjusted basis (for determining the deduction) of such property immediately before the exchange exceeded its fair market value at such time,

then in computing the amount the deduction to which the taxpayer is entitled for the purposes of this section, the basis of such stock or debenture shall be reduced by an amount equal to the excess described in (C).

"(2) Minimum holding period.--For purposes of this section, proceeds from the sale of enterprise stock or debentures shall be treated as--

"(A) is provided for in subsection 221(b), if the stock or debentures with respect to which a deduction under this section has been allowed has been held continuously by the taxpayer claiming the deduction for a period of three years from the date of purchase, and

"(B) ordinary income in the case of sale proceeds realized by a taxpayer permitted a deduction under this section or any time before a period of three years from the date of purchase has elapsed.

"(3) Deduction for original purchaser.--Taxpayers acquiring enterprise stock or debentures other than from a qualified issuer or its selling agent shall not be entitled to a deduction under this section."

APPENDIX 3

ENTERPRISE STOCK AND DEBENTURES

Questions & Answers

1. How will this provision help firms located in enterprise zones?

New companies generally obtain most of their start-up capital from the entrepreneur's friends, family members and business associates. Unfortunately, firms located in distressed areas designated as enterprise zones may find it difficult to secure financing from individual investors who have other, more attractive options. Our proposal is designed to overcome this problem by providing tax relief to people who purchase enterprise stock or debentures.

2. How would it work?

In simple terms, any individual who purchased enterprise stock or debentures (a long-term unsecured loan) would be entitled to a Federal tax deduction equalling the amount of the investment. For example, a person who put $10,000 into a qualified zone company would be able to claim a $10,000 deduction on his or her Federal tax return for that year. If the taxpayer were in the 50% bracket, the deduction would reduce taxes owed for that year by 50% of the $10,000, or $5,000. The deduction essentially allows the investor to get up to half of his or her investment back almost immediately in the form of tax savings. This should be a strong incentive to invest in zone firms.

3. Won't this proposal encourage people to make investments with no real economic value just to get a tax break?

Not really. Again, the proposed tax incentive would only give the taxpayer up to one half of the money invested back in the form of Federal tax savings. Most of the return of and on the investor's capital would have to come from principal and interest payments, dividends or from the subsequent sale of the investment. In other words, the investment will only pay off if the firm succeeds.

4. Would there be any restrictions on the types of firms which could issue enterprise stock and debentures?

Small firms -- defined as those with a net worth of $5 million or less -- which obtain at least 50% of their income from other than passive sources (e.g., rents, royalties and interest payments) would be entitled to issue enterprise stock or debentures. Real estate trusts, investment companies and other firms in the business of lending or investing money would not be able to use this form of financing.

5. Won't this proposal encourage tax-conscious people to make investments at the end of one year and sell them the next?

   Under our proposal, there would be a minimum holding period for enterprise stock and debentures of three years. Taxpayers who sold their stock or debentures during the holding period would have the proceeds taxed as ordinary income. Thus, the investor who bought stock in one year and sold it the next would have to pay back, perhaps with interest, all or part of the previous tax savings.

6. What about people who purchase enterprise stock and debentures from the original investor? Would they also be entitled to the deduction?

   No. Only the original purchaser of enterprise stock or debentures will be entitled to the deduction. Once the investment is sold to a second owner, it would lose its special tax status.

7. What about firms which are already in business and need money to expand?

   Any firm meeting the definition of "qualified zone small business" would be entitled to issue enterprise stock and debentures.

8. Will corporations be able to get the deduction by investing in subsidiaries or other firms located in enterprise zones?

   No. The incentive is available to individuals only.

9. Given the high failure rate of new and small firms, won't this proposal simply make it easy for people to lose money?

   Some investors will undoubtedly lose money. However, the incentive is aimed principally at people in high tax brackets who can afford the risk. In addition, our proposal would permit the formation of professionally managed investment partnerships to assess and make risky investments on bhealf of individual investors. For example, MESBICs and SBICs might form subsidiaries to develop and manage such investment pools.

10. Won't this provision cost the Treasury a lot of money?

No. Treasury losses attributable to the investment deduction will be more than offset by corporate taxes paid by subsequently profitable firms. According to our estimates, about 90% of the firms issuing enterprise stock or debentures would have to fail before the Treasury would face a long-term revenue loss.

Senator CHAFEE. The next panel is Mr. Russell of the National Association of Towns and Townships, and Mr. Mandes, Director of the Southern Alleghenies Commission.

All right, Mr. Russell, why don't you proceed?

STATEMENT OF BARTON D. RUSSELL, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF TOWNS AND TOWNSHIPS, WASHINGTON, D.C.

Mr. RUSSELL. Thank you, Mr. Chairman. It is a privilege to be able to testify before the distinguished Senator from the State of Rhode Island. My family roots are based there in the town of Newport; not, incidentally, on Mansion Row on Belleview Avenue, but nevertheless from the town of Newport.

Senator CHAFEE. Good. We will give you a double welcome here.

Mr. RUSSELL. We were appreciative of the attention the Wall Street Journal, incidentally, gave Johnny-cake meal the other day. We think the cream rises to the top.

With me this morning, Mr. Chairman, is Dave Gallagher, who is the NATAT's director of economic development. On behalf of the association's board of directors and the over 13,000 jurisdictions it represents, I would like to thank you formally for inviting us to comment on President Reagan's enterprise zone proposal.

My testimony will be limited to a 4-minute summary, but I would, with your permission, like to request that our full testimony and the attached documents be made a part of the record.

Senator CHAFEE. That's fine.

Mr. RUSSELL. Mr. Chairman, we support the enterprise zone experience and are pleased to see the administration include rural areas in its legislation.

Recently NATAT sponsored a national world symposium which brought together small town officials from 30 States to examine the major problems facing rural communities. One thing was clear to all of those who attended. All too often attention at the Federal level is myopically focused on the plight of urban areas. We don't deny the serious problems that exist there; however, many rural areas also suffer economic and social problems, and these problems deserve equal consideration by our national policymakers.

The Nation's smaller communities want nothing more than an equal chance to make use of national initiatives designed to ameliorate economic distress.

On March 10, 1982, just a few weeks ago, the association convened a national policy development seminar to explore the question, enterprise zones—will they work in rural areas? Steve Sabas, HUD's Assistant Secretary for Policy Development and Research, and Stuart Butler, who testified just previously, spoke at the seminar. Representatives of the Congress, major corporations, the Federal Government, and several other institutions including State and local government, made some important observations as to the necessary ingredients for a successful rural enterprise zone, and I would like to share some of those points just briefly with the committee.

First, access—as we have heard all day from many of the witnesses—to venture capital is a crucial element to the success of any small business. It will be particularly important in the startup of new business in enterprise zones.

We believe that investments in enterprise zones should be——

Senator CHAFEE. I think you had better summarize this, Mr. Russell, or you won't get through, will you?

Mr. RUSSELL. Well, I'm hoping to read quickly, Mr. Chairman. I only intend to read the next three pages.

Senator CHAFEE. All right.

Mr. RUSSELL. The availability of capital will, of course, be vital to business in any zone be it urban or rural, but we think it is particularly acute in rural. In this regard, we commend to you Senator Danforth's enterprise zone which Senator Dole made mention of this morning. We think it is worthy of special consideration.

Another important element of our concern has to do with eligibility. The administration's bill would limit eligibility for the zones to 2,500 population and above. We encourage consideration for reducing the population eligibility requirements to 600, which is what is called for in Senator Danforth's bill. We say that because we see that many small, small jurisdictions have a need and can benefit by the enterprise zone. We point to Hooper, Colo., with population of 115, that successfully completed a UDAG for 200 new jobs to that community.

Because the enterprise zone concept is an experiment, it is important that it be tried in many communities. While the administration's bill does allow rural communities to apply, it does not specify that zones must be rural in nature.

Because distressed rural communities are at a disadvantage when competing with the bigger cities with the bigger staffs, NATAT believes it would be reasonable to set aside a certain number of these rural zones. I think that was the notion mentioned by the witness from Cooper & Lybrand.

Since over a third of the U.S. population lives in rural America, we think it would be fair to set aside a third of the zones for rural designation.

Enterprise zones are aimed at helping economically depressed communities. Many of these distressed rural communities lack the specialized knowledge needed to put these complicated packages together. And, if rural zones are to be given a real chance, the legislation should insure the provision of some sort of technical assistance for these communities so that they can move forward with them.

Finally, Mr. Chairman, we believe that some provision must be made for financing basic services in the enterprise zones. All businesses need these public services and facilities—infrastructure, sewer, and water—things that are taken for granted in urban areas. But, in contrast to urban areas, basic public facilities and services are often not available in rural towns.

Since the limited tax base of most small towns will stifle efforts required to pay for infrastructure, outside financing and aid might be required. One possible solution might be to allow local taxpayers to claim tax credits for special taxes assessed by a locality to provide the services in a zone.

Another idea—I'm not sure it has been mentioned—very simply would be to give Federal economic and community development grant-award preference to communities which receive zone designation.

Senator **Chafee**. All right, Mr. Russell. We appreciate that testimony.

Mr. Mandes?

STATEMENT OF STEPHEN C. MANDES, EXECUTIVE DIRECTOR, SOUTHERN ALLEGHENIES COMMISSION, ALTOONA, PA.

Mr. **Mandes**. Mr. Chairman, I will not even summarize, at this point, but will submit it for the record and just attempt to make a few observations, if I may.

I am pleased to represent the region in Pennsylvania to which the senior Senator referred in the opening testimony this morning. And, as we submit for the record our written testimony, I do so with the expressed consent of 105 members of a private sector task force comprised of business, of management, and of labor, all of whom are committed toward making an enterprise zone work. We, too, agree that this is a bold, new initiative.

I appear, also, with the expressed consent of the top elected officials in those six Pennsylvania counties.

I can only state that we are just pleased to see the movement that has transpired in the past 2 years, and in the past several months, and in fact, Mr. Chairman, in the past several hours.

And we are very pleased to note that rural places in the United States are being given equal treatment by this committee, by this administration, in an understanding that economic distress is not a monopoly held by the urban areas, nor is the likelihood of success totally in the urban areas.

Now, we are not quite all that rural. We are Johnstown, where we used to make steel; Altoona, where we used to make railcars; and a whole lot of areas where we used to mine coal. But the mechanics of how we see an enterprise zone working in our region are in the written testimony.

I will only relate to the fact that our people in the private sector and in Government, in banking, and in education, all those people are committed toward targeting the resources within these initiatives, committed toward targeting other resources necessary to support the zone.

I would like to make one comment regarding the initiatives and echo what some people have said before in terms of capital formation for small business. We, too, agree that this is important, and we would hope that the committee would consider the initiatives embodied in Senator Danforth's legislation and said earlier here by Stuart Butler regarding the 100-percent expensing in year one.

I would like, Mr. Chairman, to make one technical comment. We noted in the administration's bill that the liability for the certification of eligible employees would rest upon the shoulders of the private sector employer. We think that that is sort of the antithesis of what the zone is about. We would respectfully suggest that that liability be held by the zone sponsor, to keep that kind of bureaucracy off the shoulder of the emerging employer, the new employer in the zone.

The other observation I would like to make, Mr. Chairman, is that I think you sent a marvelous signal out of this room today to the private sector. We pledge our cooperation to assisting you in making all of this work.

Thank you.

Senator **Chafee**. Well, thank you, gentlemen. You represent an area that I think it is well to bring to the attention of us, and Senator Heinz sounded the same note that you did. Of course, as you noticed, I think he actually wanted a specific number set aside for rural areas.

But, certainly, we will make sure that the rural part is stressed when we do the legislation.

Thank you, all three of you, for coming.

[The prepared statements of the previous panel follow:]

Testimony of Barton D. Russell, Executive Director of the National Association of Towns and Townships

Mr. Chairman, members of the Subcommittee, my name is Barton Russell. I am the Executive Director of the National Association of Towns and Townships. On behalf of the Association's Board of Directors and the over 13,000 jurisdictions it represents, I would like to thank the Committee for allowing us this opportunity to comment on President Reagan's Enterprise Zone Proposal.

Mr. Chairman, we support the Enterprise Zone experiment and are pleased to see the Administration include rural areas in the proposed legislation. Recently, NATaT sponsored a national rural symposium which brought together small town officials from thirty states to examine the major problems facing rural communities. One thing was clear to all of those in attendance at that gathering: all too often attention at the federal level is narrowly focused on the plight of urban areas. Many rural areas suffer severe economic and social problems and these problems deserve equal consideration by our national policy-makers. The nation's small communities want nothing more than an equal chance to make use of any new national initiatives designed to ameliorate economic distress.

On March 10, 1982, NATaT convened a national policy development seminar to explore the question, "Enterprise Zones: Will They Work in Rural Areas?" E. S. Savas, HUD Assistant Secretary for Policy Development and Research, and Dr. Stuart Butler, generally recognized as a top authority

ON ENTERPRISE ZONES, SPOKE AT THE SEMINAR. REPRESENTATIVES OF THE CONGRESS, MAJOR CORPORATIONS, THE FEDERAL GOVERNMENT, STATE GOVERNMENT AND PUBLIC INTEREST GROUPS MADE A NUMBER OF IMPORTANT OBSERVATIONS AS TO THE NECESSARY INGREDIENTS FOR A SUCCESSFUL RURAL ENTERPRISE ZONE. I WOULD LIKE TO SHARE SOME OF THE POINTS MADE AT THAT SESSION WITH THIS COMMITTEE.

FIRST, ACCESS TO VENTURE CAPITAL IS A CRUCIAL ELEMENT IN THE SUCCESS OF ANY SMALL BUSINESS, AND IT WILL BE PARTICULARLY IMPORTANT IN THE STARTUP OF NEW BUSINESSES IN ENTERPRISE ZONES. WE BELIEVE THAT INVESTMENTS IN ENTERPRISE ZONES SHOULD BE MADE AS ATTRACTIVE AS POSSIBLE, TO COMPENSATE FOR THE GREATER RISKS ACCOMPANYING INVESTMENTS IN DEPRESSED AREAS. THE AVAILABILITY OF CAPITAL WILL, OF COURSE, BE VITAL TO BUSINESSES IN ANY ENTERPRISE ZONE, BUT WE BELIEVE THE NEED MAY BE PARTICULARLY ACUTE IN RURAL AREAS. IN THIS REGARD, SENATOR DANFORTH'S ENTERPRISE ZONE BILL IS WORTHY OF SPECIAL CONSIDERATION.

ANOTHER IMPORTANT CONCERN IS ELIGIBILITY. THE ADMINISTRATION'S BILL WOULD LIMIT ELIGIBILITY FOR ENTERPRISE ZONES TO COMMUNITIES OVER 2,500 POPULATION, WHICH MEET THE "ECONOMIC DISTRESS" REQUIREMENTS SET FORTH IN THE URBAN DEVELOPMENT ACTION GRANT PROGRAM. WE BELIEVE THAT THIS FIGURE IS TOO HIGH. MANY COMMUNITIES UNDER 2,500 POPULATION NEED HELP AND WOULD MAKE GOOD SITES FOR ENTERPRISE ZONES. FOR EXAMPLE, HOOPER, COLORADO, POPULATION 115, SUCCESSFULLY COMPLETED A UDAG PROJECT WHICH BROUGHT 200 NEW, PERMANENT JOBS TO THAT

TINY COMMUNITY. NATaT SUGGESTS THAT THE 600 POPULATION CUTOFF IN SENATOR DANFORTH'S RURAL ENTERPRISE ZONE BILL BE SUBSTITUTED FOR THE LIMIT PROPOSED IN THE ADMINISTRATION'S BILL. THIS WOULD ENABLE APPROXIMATELY 4,000 ADDITIONAL COMMUNITIES TO BE ELIGIBLE FOR ENTERPRISE ZONE DESIGNATION.

BECAUSE THE ENTERPRISE ZONE CONCEPT IS IN ITS EXPERIMENTAL STAGES, IT IS IMPORTANT THAT IT BE TRIED IN MANY DIFFERENT KINDS OF COMMUNITIES. BUT, WHILE THE ADMINISTRATION BILL DOES ALLOW RURAL COMMUNITIES TO APPLY, IT DOES NOT SPECIFY THAT ANY OF THE ZONES MUST BE RURAL IN NATURE. BECAUSE RURAL COMMUNITIES ARE AT A DISADVANTAGE WHEN COMPETING WITH LARGE CITIES, NATaT BELIEVES IT WOULD BE REASONABLE TO SPECIFY A CERTAIN MINIMUM NUMBER OF THE ZONES FOR RURAL AREAS. SINCE OVER ONE-THIRD OF THE U.S. POPULATION LIVES IN RURAL AREAS, WE SUGGEST THAT ONE-THIRD OF THE ZONES BE LOCATED IN RURAL AREAS, THAT IS, OUTSIDE OF STANDARD METROPOLITAN STATISTICAL AREAS.

ENTERPRISE ZONES ARE AIMED AT HELPING ECONOMICALLY DEPRESSED COMMUNITIES. BUT MANY DISTRESSED RURAL COMMUNITIES LACK THE EXPERTISE AND SPECIALIZED KNOWLEDGE OFTEN NEEDED TO PUT TOGETHER COMPLICATED APPLICATIONS. IF RURAL ENTERPRISE ZONES ARE TO BE GIVEN A REAL TEST, THE LEGISLATION SHOULD ENSURE THAT TECHNICAL ASSISTANCE FOR RURAL COMMUNITIES WILL BE AVAILABLE TO PROVIDE THE NECESSARY HELP TO PUT TOGETHER AN ADEQUATE PROPOSAL.

Finally, we believe that some provision must be made for financing basic services in the enterprise zones. All businesses need public facilities and services -- water, sewer, police, fire, and so on -- whether they are in urban or rural areas. But, in contrast to urban areas, basic public facilities and services are often unavailable in many rural communities. Since the limited tax base of most small towns will stifle efforts to put required infrastructure in place, outside financing and aid may be necessary. One possible solution might be to allow local taxpayers to claim federal tax credits for special taxes assessed by a locality in order to provide basic facilities or services to the enterprise zone. Another idea would be to give federal economic and community development grant awards preference to communities which receive zone designation.

This concludes my oral testimony concerning possible improvements to the Administration's enterprise zone legislation. I would like to submit other documents on this issue for the record.

We believe the suggestions mentioned today would help to ensure that the Administration's proposal would provide real help to our rural communities. We are eager to work with the Committee and the Administration to develop an enterprise zone bill which will help rural as well as urban areas. We have already mentioned Senator Danforth's praiseworthy efforts; Representative Watkins of Oklahoma has also

INTRODUCED A RURAL ENTERPRISE ZONE BILL WHICH CONTAINS A NUMBER OF PROVISIONS THAT MIGHT ALSO INTEREST THIS COMMITTEE.

THE PRESIDENT'S BILL GIVES US ALL A SOLID BASE TO BUILD ON. TOGETHER WE CAN BEGIN AN EXCITING EXPERIMENT IN ECONOMIC RENEWAL FOR AMERICA'S DEPRESSED URBAN AND RURAL COMMUNITIES. AGAIN, MR. CHAIRMAN, WE APPRECIATE YOUR INVITATION TO TESTIFY THIS MORNING AND HOPE OUR COMMENTS PROVE BENEFICIAL TO THE WORK OF THE COMMITTEE.

ENTERPRISE ZONES

Will They Work in Rural Areas?

A Public Policy Seminar

March 10, 1982

Sponsored by the

National Association of Towns and Townships
1522 K Street, NW, Suite 730
Washington, D.C. 20005
202/737-5200

April 1982

Can enterprise zones work in our nation's rural areas?

According to President Reagan's State of the Union message earlier this year, enterprise zones would bring "new business, new jobs and new opportunity to America's inner cities and rural towns."

There are several proposals now in Congress to create enterprise zones. All of them share the goal of stimulating economic activity and employment in distressed areas by using federal tax and regulatory relief to entice new business to locate in those areas.

Urban enterprise zones have received extensive media coverage and national attention. The concept has been put to work in some cities in England, and community leaders are ready to try it in the South Bronx and Baltimore. The question is whether the idea will work in rural areas in this country.

There is an unquestionable need for a major rural development initiative in our nation today. Even though jobs and population are growing in some small towns, poverty and economic stagnation are still the rule in too many rural communities.

More than 460 rural counties lost population during the last decade because of a loss of farm jobs and a lack of alternatives for workers. Communities in these areas, for one reason or another, have been unable to attract the business or industry that would provide new jobs and new hope for rural people.

As the national spokesman for small rural towns across the country, the National Association of Towns and Townships sponsored a seminar in March to focus much-needed attention on whether or not enterprise zones will help revive these areas. We brought together leaders from Congress, federal agencies, public interest groups, and business to take a look at the concept. By inviting the media, we took a step toward attracting the national attention that we hope will eventually spark the involvement of more economic development policy-makers and practitioners.

This report highlights the comments of noted development experts featured on the seminar panel:

E. S. Savas, assistant secretary for policy development and research at the U.S. Department of Housing and Urban Development, has had the primary responsibility for drafting the administration's recently released enterprise zone proposal. He reviewed the plan's basic components and emphasized the critical role of state and local governments.

Stuart Butler, senior fellow with the National Center for Neighborhood Enterprise and consultant to the Heritage Foundation, is a leading authority on enterprise zones in Great Britain. He outlined the British experience and listed some warnings for rural areas.

Roy Green is a member of the staff of the Senate Subcommittee on Federal Expenditures, Research and Rules. He explained the main features of subcommittee Chairman John Danforth's proposed Rural Enterprise Zone Act.

The overview was provided by moderator Paul Pryde, president of Janus Associates, a community development consulting firm. He pointed to trends that have created a favorable political climate for enterprise zones, but cautioned the audience of potential problems.

"Enterprise Zones: Will They Work in Rural Areas?" is one in a series of NATaT's Rural Policy Development Seminars.

Because of the dramatic need for development initiatives in rural areas, NATaT is sponsoring an April seminar on local government finance, budget cuts and the new federalism. Local government officials and other participants will investigate creative financing techniques and methods for cooperation among the federal, state and private sectors.

In May, the association will co-sponsor a seminar on rural population growth and economic development. Participants will examine the burdens that growth has placed on local governments, discuss ways to respond to related problems, and look at new opportunities for rural economic development.

One of NATaT's primary missions is to conduct policy research and analysis on issues affecting small towns and rural areas. We hope that this report and our seminar series will help provide some direction as our nation debates how it can best respond to the need for assistance in rural communities.

Barton D. Russell
Executive Director
National Association
of Towns and Townships

THE FEDERAL ROLE: from commanding to coaxing

We are undergoing a period of profound change, especially regarding the federal role in the economy, according to panel moderator Paul Pryde, who said that the federal role is shifting in emphasis from "prescription to inducement."

The federal government used to take more of a "command and control" posture, he explained, but now it attempts to induce market forces to take positive action on their own. Enterprise zones, with government incentives to draw business to economically depressed areas, are a prime example, he said.

But, he pointed out, there are other factors which have a greater influence on the decision of a business to locate in a certain area:

1. The "quality of the local environment." Employees must feel safe in the neighborhood and have access to needed amenities and services.
2. The availability of capital at a reasonable cost. This plays a major role in the location and expansion of a young business, which creates the most new jobs.
3. The availability of trained and productive workers.

Still, he concluded, tax incentives such as those used in enterprise zone proposals do have a role to play in helping to develop depressed areas, and the enterprise zone concept is one which should be examined.

THE BRITISH DIFFERENCE: more for big business

One of the basic purposes of an enterprise zone is to "remove barriers" to business activity, said Stuart Butler, British development expert and senior fellow at the National Center for Neighborhood Enterprise in Washington.

Entrepreneurs will be willing to experiment if the right conditions are present, so an enterprise zone designed to attract new businesses must "create a climate to encourage risk-taking." That climate includes factors such as crime in the area, job skills in workers, local government regulations, and insurance costs.

Butler, a British economist who is credited with introducing the enterprise zone concept to the United States, pointed to a few differences between the approach in Great Britain and in the United States.

1. British enterprise zones are purely industrial sites, while U.S. initiatives usually call for mixed use and a minimum resident population within a designated zone.
2. There has been an emphasis on new, small business formation in the U.S., since new business is the greatest source of new jobs. In Great Britain, tax credits usually favor large businesses with sizeable tax bills.
3. There is a much larger role for local government and private organizations in the U.S. approach.

Special Small Town Problems

Economic problems are just as severe in some rural areas as in depressed urban areas, Butler said, but any attempt to apply the enterprise zone concept to small rural towns "should stress diversity" to prevent an area from "being captive to one industry."

Some facts of small town life could easily discourage new business activity, Butler said. The large pool of entrepreneurship that is needed for its ideas and creativity will not be found in a remote town of 4,000 as it is in mid-Manhattan, for example. A small isolated population also means a lack of needed back-up and technical support. Small towns may even try to put constraints on new business activity, Butler warned, because the idea of change in the community may be suspect.

THE ADMINISTRATION'S PLAN: create more jobs

The Reagan administration's yet-to-be released* enterprise zone plan would encourage job-creating, entrepreneurial action through tax and regulatory relief and improvements in local services.

These factors would create new economic activity and jobs rather than re-order existing business activity, according to E.S. Savas, HUD assistant secretary for policy development and research. No federal appropriations would be involved and no priority given either urban or rural areas in the administration proposal.

The plan's designation process calls for state and local governments to apply to HUD and compete for designation under the criteria now used for Urban Development Action Grants. A maximum of 25 zones would be designated each year for three years. The federal designation would last 20 years. There would be no special provisions for rural zones.

The proposal's tax package would encourage labor-intensive, new business by eliminating the capital gains tax, providing payroll tax credits, a tax incentive for the hiring of the hard-core unemployed, and a modest employee tax credit to encourage job-taking.

To attract capital to the zone, the use of small issue industrial bonds would be permitted.

If requested by state and local governments, federal agencies would relax non-statutory regulations. Savas stressed that "obscure rules and regulations" could hamper business development.

State and Local Roles

State and local government "can make the crucial difference between success and failure," Savas stressed. No state or local tax or regulatory relief would be mandated, he said, but he suggested a relaxation of planning and zoning controls, permitting requirements, and building codes that "date from the last century and are the bane of small business."

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* The administration proposal was released on March 24.

To draw business into a designated enterprise zone, local governments may have to make some improvements in their infrastructure, such as roads and sewers, or in services such as fire protection and refuse collection, Savas said. They would be free to use Urban Development Action Grant or Community Development Block Grant funds for those purposes.

Savas echoed Butler's warning that rural areas may not have the "critical mass" of entrepreneurial talent needed to make the enterprise zone concept work. But, he said, the smaller size of the community could be beneficial, too. A single enterprise zone would have a much greater impact on the economic well-being of a small town than one on that of a large city.

A PROPOSAL FOR RURAL AREAS: cooperation is the key

Rural areas would face a distinct disadvantage in competing with cities for enterprise zone designation, so they need a program tailored to their unique needs, said Roy Green, committee aide to Sen. John Danforth, R-Mo., chairman of the Senate Subcommittee Federal Expenditures, Research and Rules.

Danforth's proposed Rural Enterprise Zone Act is co-sponsored by Sens. Mark Andrews, R-N.D., Charles Grassley, R-Iowa, Paul Laxalt, R-Nev., and Harrison Schmitt, R-N.M. It would allow up to 15 zones to be created in each of three years, beginning in January 1983, and provides tax incentives to investors.

The bill would allow states, local governments and even private firms to sponsor the designation of an enterprise zone, but there would have to be solid cooperation among the three to make a proposal that would have a chance for designation, Green said.

The bill would require a minimum population of 600 in an area located outside of a Standard Metropolitan Statistical Area.

The criteria for designation would be broad community support, availability of commercial property in the proposed zone, a commitment from state and local governments and private business, and minimal federal expense.

To receive the federal tax benefits, a company located in the zone would have to be small or less than five years old, and receive 50 percent of its revenue from inside the zone. Existing businesses must increase their employment in the zone by 10 percent over the level prior to designation. There would be a bigger role for regulatory relief on the state and local level rather than the federal level, Green said.

Tax incentives would include deferral of capital gains taxes, a jobs tax credit for hiring hard-core unemployed, and a neighborhood tax credit for contributions made to the provision of public services in the zone.

The limited number of zones would allow capital to collect in each since there would be no competition for investment dollars from other zones in the same region, according to Green. But the critical factor, he reiterated, is a community consensus that an enterprise zone is needed.

CLOSING THOUGHTS: potential problems

In closing the discussion, moderator Paul Pryde cautioned the audience to consider several potential problems:

1. A great deal of creativity is needed to make enterprise zones work, and rural areas may not have the needed mass of talent.

2. Since the enterprise zone concept is an experiment, no one really knows if it will work.
3. If the concept does work, it will probably be applied everywhere, giving distressed areas at most a few years' head start in the competition for business.
4. Depressed rural areas may face a tremendous problem in improving the infrastructure and service delivery needed to attract new business.

TESTIMONY BY STEPHEN C. MANDES

My name is Stephen C. Mandes. I am the Executive Director of Southern Alleghenies Commission. The Commission was created in 1967 as a regional economic development body by the Commissioners of the Pennsylvania Counties of Bedford, Blair, Cambria, Fulton, Huntingdon and Somerset. It is in the behalf of the Commissioners and businessmen of these six counties upon which my testimony today is based.

First of all, we wish to commend those national leaders who are taking a positive initiative to propose an action heretofore untried: that of eliminating government intervention in the market place in order to help stimulate business expansion and creation in order to alleviate problems of economically distressed areas. The enterprise zone experiment is indeed a bold venture to undertake. In addition, we commend those leaders who have the foresight to realize that this experiment should not be initiated in urban areas alone, but should also be initiated in areas of distress in small towns and rural areas throughout the Country.

In this testimony, we want to demonstrate that the application of the enterprise zone approach to economic development makes sense in the Southern Alleghenies Region, that it can actually work in rural area, and most importantly, that it is essential to the prospects for economic revitalization and job creation. To be clear at the outset, we endorse the concept of enterprise zones, for we feel that its application will assist us in solving our economic problems. Further, we feel that with minor modifications, the initiatives proposed by the Reagan Administration can serve our purpose.

We wish to place this testimony within the context of a series of questions. First, why does an enterprise zone make sense for a rural area. Second, why does it make particular sense for the Southern Alleghenies Region. Third, what is needed for economic revitalization of the Region, and how would an enterprise zone work to meet those needs. Fourth, are proposed federal approaches adequate to meet those needs, and if not, how can any deficiencies be remedied. We will present our specific concerns and make recommendations. An finally, what can we achieve if adequate legislation is passed and if designation is available to the Southern Alleghenies Region.

Why Rural Zones, and What is the Rationale for a Southern Alleghenies Zone?

The intent of enterprise zones, as stated by the many legislative and Administration sponsors, is to use targeted tax incentives and regulatory relief to create jobs and cause investment in economically distressed areas. In that statement, there is careful avoidance of the term, "urban" economic distress, and for good reason. Across the nation, the problems of economic distress are not limited to urban inner city areas, but in fact are found in broader areas. The problems of chronic and structural unemployment, of poverty and disinvestment, of loss of population and physical blight are just as pervasive in rural areas as in urban areas. The approaches that have been used over past decades have been just as limited for addressing rural poverty as they have for urban areas; the same bankruptcy of policy and performance can be found in prior rural economic development efforts. To focus exclusively on urban poverty and economic distress implies a callous indifference to equal problems found outside the major urban centers. Therefore, we welcome the broader focus on rural and urban areas in proposed enterprise zone initiatives. It shows the Administration and legislators recognition of the equal set of problems and the commitment to use enterprise zones to address those problems in not only cities, but within towns and rural areas. We thank Senator Danforth, Congressman Watkins and other Members of Congress who have recognized this understanding through rural enterprise zone legislative initiatives.

As an employee of a six-county, multi-jurisdiction body located in southcentral Pennsylvania, I find the consideration of rural areas particularly important. Although the Southern Alleghenies Commission covers a large -- and basically rural -- area, the total number of population who lives there is equal to the population of many major cities. The Region's population is comparable in size to Buffalo, Pittsburgh, St. Louis, Kansas City, or Cinncinati, or even to Harlem and South Bronx. Many of the problems that confront the area are the same as those in inner cities, in spite of the population distribution. For example:

- The rate of unemployment in the Region approaches 18 percent, double the national average; areas within the Region have over 30 percent unemployment.
- The per capita income level is less than $6,800 -- less than Pennsylvania, other northern industrial states, and the United States as a whole.
- The stock of residential, commercial and industrial facilities is aging, and limited resources are available to rebuild them.
- The number of persons receiving public assistance is increasing, with over 25,000 now receiving some kind of aid. What is more dramatic is the persistence of such aid, with many receiving assistance for very long periods. The number of people dropping out of the labor force -- that is, becoming chronically unemployed -- is growing. Those moving out of the area in search of work is bitter testimony to the degree of economic plight.

While the rest of the nation is in a recession, we are experiencing unemployment conditions that approach the severity of the Depression. The prospects that our economy will recover with the national economy are limited because the fundamental problem underlying these conditions is the erosion of the economic base. The major industries in the area -- steel production, coal mining, railroad maintenance and operations, and small-scale agriculture -- have all suffered from downturns in the national economy, but more importantly, have become either physically or technically obsolete. World and national markets have shifted, and the economic base on which the regional economy was founded has been abandoned. Thus, although the Region is predominately a rural area, the extent of the problem is large, and the need for treatment is considerable.

What is Needed, and How Would and Enterprise Zone Help?

The citizens of the Region have not been idle in dealing with these problems. Strenuous efforts have been made, and will be made to remedy the economic situation. We are presently trying to revitalize the manufacturing base that is so important for the Region -- and for the nation. We are trying to diversify that base into new growth industries, and into the service and distribution sectors. We are doing all we can to encourage small business development.

The solution, as we see it, is to do all that is necessary by those of us in the public sector to allow the private sector to create jobs. To accomplish that means creating an optimal business environment, oriented to growth and expansion. It is our intent to encourage business development and to aggressively seek out and remove barriers that impede business development. We, furthermore, feel that this single-minded purpose can best be accomplished through the types of actions and incentives available with a Southern Alleghenies enterprise zone.

What are the Key Features of a Southern Alleghenies Enterprise Zone?

We propose very selective and careful use of incentives in targeted areas scattered throughout the Region. Those incentives would be concentrated on areas where :

1. the factors for economic development are favorable;
2. where use of incentives will trigger business activity and investment; and
3. where the greatest distress can be alleviated.

Given this judicious use of incentives and targeted assistance, we feel that the selected areas will improve and prosper. The jobs that are created by such targeted assistance would be provided for residents of the Region as a whole, but particularly for those near the target areas. The benefits from the increased activity would accrue to the target areas, as well as to the Region as a whole.

Key features of the Southern Alleghenies approach would include:

- Careful attention to all the requirements for economic development. Based on the 15 years experience of the Southern Alleghenies Commission in fostering economic development, we feel that a comprehensive approach works best. That is, it is necessary to combine efforts at job training, capital formation, infrastructure and site preparation, small business development assistance, marketing and promotion, and overall management in flexible, creative ways in order for economic development to occur. To neglect any of these factors limits the possible success of any project. Our approach to the enterprise zone builds on this experience. Use of targeted incentives and regulatory relief does not remove the need to address all these needs at the same time, and to package them in useful ways for each business. Our recent visits to successful enterprise zone sites in the United Kingdom -- as part of our ongoing efforts to develop the Southern Alleghenies zone -- confirmed the need to pay attention to all factors of development.

o Selection of target areas to ensure success. As stated, we will focus our efforts on target areas, but we will not merely draw boundaries around those areas where the economic problems are the greatest. We will combine those areas with areas where there is potential for successful economic development -- in terms of availability of land, infrastructure, business interest and commitment, possible sources of financing -- so that businesses can succeed. This attention to ensuring success is important for it also ensures that jobs for residents of the Region will result.

o Two-tiered application of incentives. We expect to combine various tax and regulatory incentives -- assuming designation for use of federal incentives, coupled with state and local incentives and activities -- to encourage job creation and investment in target areas. We would apply a full dose of incentives to fairly confined areas, where largely commercial and industrial activities would locate; businesses would receive incentive packages in return for commitments to locate and operate in target areas, to make investments, and to hire qualified individuals. Surrounding those sites would be preferred labor markets, where residents would be given priority consideration for some of the employment opportunities that would make available. In this second tier, lesser incentives would be used. Given the limited resources that can be applied in enterprise zones, we would not neglect the small scale commercial and residential needs, but they would be subordinated to the crucial activity of encouraging job creation and revitalization. This two-tiered approach will ensure that incentives directed to businesses are limited and focused, yet will ensure that those individuals that have been crowded out of the labor pool can be restored to full employment.

- Varied financing for zone activities, with self-sustaining financing as the ultimate aim. We assume that present federal and state programs oriented to economic activity will continue, and we intend to target those programs to the extent possible to support the enterprise zone. However, most of the activities of the Southern Alleghenies zone would be financed by revenues generated by the zone's increased economic activity. Specific revenue sources would include: proceeds from land sales or rentals, property and other taxes diverted from their current use to targeted areas. Our ultimate and attainable objective is that the zone become self-sustaining so that the revenues resulting from zone activities will be sufficient to pay for zone improvements and activities.

- Experimentation in innovative labor/management arrangements and in private sector provisions of government facilities and services. We feel that Southern Alleghenies enterprise zone affords a unique opportunity to experiment with innovative labor/management arrangements. Our Region is highly unionized and our past history has resulted in a badly perceived notion of confrontations between labor and management. However, our more recent experience has been quite to the contrary. We have initiated a series of labor/management committees, operating in many of our industrial facilities, that are exploring ways that can benefit both labor and management. We expect that once our enterprise zone is established, we will continue this exploratory effort. Similarly, we already have undertaken careful investigation of how provision of public services and facilities can be made more efficient and cost-effective by private sector providers. We have initiated a number of activities, and expect that within the framework of the enterprise zone, further experimentation will occur.

- Performance-based management and administration of the zone. We expect that all activities in the zone will be carefully considered and monitored, to ensure that our overall objective of job creation and revitalization is met. To this end, we will encourage zone participants -- local jurisdictions, representatives of state government, business leaders, labor representatives, and members of community organizations -- to make commitments in support of the zone. We will then use those commitments to measure how the zone participants are performing. In this way we will be able to readily understand how the zone is working and to determine if changes in the direction or allocations of resources are necessary. As a further aspect of zone management, we anticipate that commitments will be made on a rolling five-year basis, whereby each business agrees to what activities it will provide for the next five years. Each year, the fifth year's commitment and level of performance would be reexamined and agreed upon. If any business chooses to leave the zone or to cut back on its commitment, it would be phased out over five years. On the other hand, if changing economic conditions warrant it, there is the potential to deliberately alter the direction, pace, and resource allocations of the zone. Early indications from among businesses interested in the zone show support for this approach, which provide certainty for the businesses, yet allows a degree of flexibility in zone management.

- Careful attention to community support. There has been a long tradition of community activism and participation in support of the Southern Alleghenies Commission. Through the Commission's processes, a sense of the Region is established; old programs and initiatives are reviewed, redirected where necessary, scrapped if unproductive, and appropriate programs are initiated. In either case, the ultimate policy-making body is the membership of the Commission. With over 350 volunteer, active members, working through 20 committees and 40 subcommittees -- organized in response to recurring and newly emerging issues -- a very representative and responsive body is actively directing the policy and activities of the Commission. Given the nature of this body, it is noteworthy that there was a unanimous endorsement of the decision to pursue enterprise zone designation at the most recent annual meeting. This commitment not only demonstrates that the community backs the enterprise zone initiatives, but that any further efforts must be shaped according to the wishes of the Commission membership.

- Use of Southern Alleghenies Commission as an "honest broker".

  We have not imposed a centrally planned nor artificially contrived zone approach on the Region. Rather, as indicated by the grass roots support for the zone, the citizens of the Region -- through their representative body -- continue to express their will. The presentation of choices and the selection of alternatives, as well as the day-to-day chores of zone administration, would fall to the Commission. Once designation is received, the Commission would then serve as a broker or implementor of the enterprise zone, helping to establish and then monitoring the commitments made by zone participants. This role of "honest broker" has traditionally been performed by the Commission, and is clearly the role that would be assigned to the Commission by all constituent groups in the Region. Similarly, in its role as "honest broker", the Commission has worked through other organizations -- including member local governments and the Region's business community. By providing leadership and serving as a catalyst, the Commission will provide valuable support to the enterprise zone.

In summary, then, we expect that if federal designation is provided for the Southern Alleghenies enterprise zone, the economic development efforts of the Region will be enhanced, and the possibility of alleviating the economic development problems that have plagued us is greater. With the enterprise zone, we expect there will be value from the tax incentives and regulatory relief provisions in themselves as an inducement to business. Moreover, the enterprise zone affords an opportunity to experiment with labor-management relations and privatization of government services; without the zone, it is doubtful that some of the promising ideas in this area could in fact be carried out. Likewise, the availability of enterprise zone incentives will aid in enforcing commitments made to the zone -- to become involved in the first place, and then to stay involved once the zone begins operation. Lastly, enterprise zone designation represents an opportunity for us to promote economic development -- for when the proposed incentives and activities are combined with the programs that are already underway or contemplated, we will have a competitive and attractive package to offer to business. In short, we will be able to provide the high-quality, enterprise-oriented business environment that we clearly see as our overall purpose for the enterprise zone.

What are our concerns and what do we Recommend?

From our analysis of proposed federal legislation, and in particular the initiative recently issued by the Administration, we find that there are features of all bills that would work to support our rural, employment-oriented zone. There is no bill, however, that would completely provide the kind of assistance that is necessary. In these hearings, we are pleased to present our suggestions on how proposed legislation could be modified -- to not only improve it for our purposes, but also for other communities that are considering an enterprise zone approach to their problems. Those recommendations are listed:

- The definitions and other provisions pertaining to zone sponsors and applicants should be clarified to ensure that multi-jurisdictional bodies with strong capabilities and experience for managing and administering zones are not barred. In fact, we feel that such management capability should be a key consideration for every zone applicant or sponsor.

- We further feel that although present legislation includes rural-based zones, there should be a statement in the legislation that expressly directs HUD or other designating agencies to balance rural applications equally with urban applications.

- We feel it is important that Congress direct the Administration to consider a range of zone types and approaches. It has been touted as an experimental program, and the willingness to experiment should be rewarded by designation for well-conceived and well-managed zones. We feel that our approach, tailored to our unique needs and appropriate to a rural area, could serve as a model of the type of innovation and experimentation that is encouraged.

- We have some difficulty with the provisions in the Administration's bill that call for state employment security offices to certify qualified workers and for the liability for error to fall upon zone businesses. We would suggest that zone sponsors have that responsibility. In particular, we envision that the Southern Alleghenies Commission would not only assume this responsibility -- and can effectively provide that assistance -- but would bear the liability should there be any erroneously granted credits, rather than have participating businesses take that liability. This is simply based upon the zone concept of removing paperwork burden from the shoulders of private industry as well as some real world experience with the Trageted Jobs Tax Credit Program.

- We suggest that the federal management of the enterprise zone program -- including application, designation, and monitoring for compliance -- should be performance based. That is, zone applicants should state the nature of their commitments, should estimate the likely costs and benefits, and should be measured against their ability to attain their stated results. If the zone sponsor falls short, then HUD would carefully review the activities in the zone, and consider suspension or revocation. This careful attention to performance will ensure that the expected and intended results of the program will be achieved. We would be comfortable operating under such rules, and would like to see others required to do so. We further recommend consideration of the rolling five-year commitment be given in federal legislation, as a feature of HUD administration and as a requirement for each zone sponsor, for it seems a sound principle by which to manage and operate the zone.

o With regard to incentives, one of the major short-comings of the Administration's proposal may be the lack of attention to providing for investment capital for zone businesses, particularly the new, small entrepreneur. We suggest that the provisions for expensing investments included in Senator Danforth's legislative proposal be included in the Administration's billfor small businesses. This mechanism will remedy a critical failure to provide assistance necessary to business growth and development. The Administration's proposed investment tax credits for zone businesses could well serve the need of stimulating larger corporate investments.

o Another problem that we can foresee with the proposed package of incentives is that many young businesses are not profitable in their early years, and therefore would not be influenced by the types of tax incentives provided in legislative proposals. Given that, the ability to attract new businesses to the zone would be limited. We suggest consideration of trading of taxes losses and carryforwards among zone businesses. This would be permitted only among qualified businesses in the zone, and would be restricted in both amount and number of years allowed for trading unuseable tax credits. This mechanism will reinforce the use of other incentives, and will aid the cash flow and operating costs of businesses in the zone.

- We find it necessary to suggest clarification of the provisions pertaining to regulatory relief in legislative proposals. We have found from our experience that the solutions to the problems of regulation lies not so much in the wholesale elimination of regulations, but more in the careful attention to even-handed and timely administration of regulations. Therefore, we suggest that in formulating the enterprise zone legislation, careful distinctions should be made between regulatory elimination and better administration of regulations. Whatever can be done to expedite and rationalize the decision-making for regulatory purposes should be done. And zone sponsors should not only be willing to entertain alternative approaches to administration of regulations, but also provide the leadership, commitment, and political will to enforce such differential administrative activity.

- Finally, we urge that existing programs for economic and community development be kept intact. To attempt the type of comprehensive development implied by enterprise zones without complementary tools and programs could well handicap the prospects for an effective test of the concept.

What Can We Accomplish?

If the types of remedies suggested for legislation are provided, if designation is received and federal incentives are available, and then if the Southern Alleghenies enterprise zone approach as outlined is put into operation, we expect the following results:

- On the cost side, there will be federal and state tax expenditures -- in terms of revenues foregone by the provision of tax incentives. There would also be the costs of improved and targeted services in the enterprise zone.

- Arrayed against such costs are the potential benefits from establishing and operating an enterprise zone. As mentioned, there are indirect benefits from the type of coalition-building and unity that is required to make a zone work, from the promotional and marketing efforts that should accompany zone operations, and from the ability to concentrate resources and attention on selected target areas. In themselves, these are important benefits.

- The more tangible benefits that we expect from zone operations include the following:
    - increases in jobs and investment, due to increased business activity in the zone.
    - increases in corporate and personal income taxes, in direct proportion to the new business activity that is created; these revenues will flow to both federal and state coffers, offsetting some of the tax expenditure costs.
    - Local jurisdictions will gain from increased values in the zone to the extent that property values increase where

previously there was little or no revenue potential, there is a net benefit from zone activity.

- because it is likely that healthier businesses with heftier payrolls will lead to additional spending in the Region, there is an added indirect economic benefit through a regional multiplier; overall demand for goods and services in the Region will rise with the added business activity in the zone.
- with the hiring of qualified employees who have previously been on some form of public assistance, there is a double benefit; the possibility for such workers to contribute by paying income and other taxes has been mentioned, but the reduction in public assistance costs by removing that worker from such payments is a savings in public expenditures.
- improvements in physical conditions, with investment in rehabilitation and new facilities; vacant or underutilized sites would be developed, and obsolete or deteriorated structures could be upgraded or demolished, benefiting previously blighted and run-down areas.

We expect that overall benefits will outweigh costs by a substantial margin. Early analysis indicates that we should not settle for less than a five to one ratio of benefits to costs, and that a ten to one ratio is attainable. The return on investments of tax expenditures and other costs is fully acceptable, and the expected benefits seem significant. If we are judged by our performance, we feel confident we can demonstrate that not only does the application of the enterprise zone concept make sense, but that it will work for our purpose in the Southern Alleghenies Region.

And we would certainly be remiss if we did not note the efforts of the Senior Senator from Pennsylvania in his expressed interest for adequate capital formation linking enterprise zones with existing federal programs and his concern for our area.

We thank you for the opportunity to present this testimony today, and we congratulate you on exploring how enterprise zone might assist the economically distressed and improverished areas in this country, be they urban or rural, to full economic recovery, and to full participation by the disadvantaged in the mainstream of economic life.

Senator CHAFEE. Now, this final panel is Mr. Mariotta, Mr. Fred Williamson, Mr. Vincent Panichi, and Mr. Bernard Berkowitz.

So, gentlemen, if you will come up.

Is Mr. Chaikin here?

Mr. CHAIKIN. Yes.

Senator CHAFEE. Don't despair.

Mr. CHAIKIN. I never have, yet, Senator.

Senator CHAFEE. The roll of the dice somehow puts you in the cleanup position.

All right, gentlemen, why don't you go ahead?

Now, we have time limitations. And, Mr. Mariotta, I had the pleasure of hearing your testimony, so why don't you summarize what you are doing.

Mr. MARIOTTA. OK. I see that is what exactly has to be done. The burden is going to be 10 times harder on me because I haven't got a high school education, and I've got marbles in my mouth.

Senator CHAFEE. Don't spend time on that. You've got four minutes. Go right to it.

Mr. MARIOTTA. OK. Here we go, 1-2-3, getting off.

Senator CHAFEE. Go.

Mr. MARIOTTA. OK.

STATEMENT OF JOHN MARIOTTA, PRESIDENT, WELBILT ELECTRONIC DIE CORP., BRONX, N.Y.

Mr. MARIOTTA. Welbilt is a living example of what everybody here thinks is the theory. This is not a theory; with Welbilt, it exists. It is a proven fact with Welbilt.

We have approximately 350 people that have come out of welfare. These are dope addict people and people that have come out of the jails.

Now, out of 350 people, I say, at $20,000 to $25,000 that is required to maintain a family in welfare, we have had in the past 5 years 950 people; 950 people represent a tax saving to the taxpayer of $19 million. We produced in the interim $24 million of defense products. That means we have saved the taxpayers of this country $43 million in the last 5 years. Statistics show that, if we continue for the next 5 years, we will produce another $92 million.

Now that I have shown you that this thing can be proven, don't penalize us like the Vietnam veterans, all right? Don't treat us any worse than the Vietnam veterans who, when the draft dodgers left the doggone—and we stood there on the battlefield and spilled the blood, and everything else, don't come around giving all the draft dodgers all the beautiful doggone things that we cannot have.

So, I am saying, by golly, you have to take us into consideration. We are the heroes. You don't bury heroes. Give us the same consideration that you are giving the new ones coming in.

What more can I say, sir? Otherwise, it's not fair. OK?

Senator CHAFEE. What is your point? That you might not be included in the zone?

Mr. MARIOTTA. Exactly, sir. Meaning that we are not included in the zone, and we've got 350 people. I'm not asking you to start from day one or retrofit it from day one, but let's start right off from the beginning, from that day that you'd get anybody else to come into the zone, that we are entitled. We've got 350; then, 350 were entitled to the same benefits of anybody coming in.

Senator CHAFEE. Wait a minute. You don't know that you won't be included in the zone. But this is the problem, as Senator Dole mentioned in his opening statement. We run into the problem—where should we draw the line?

Let's say, for example, that in the drawing of the lines Welbilt wasn't included. Now, what do we do? Do we therefore fail to proceed with the whole project?

Mr. MARIOTTA. No, by golly, you don't fail. No, don't. You've got a good thing going; don't kill it. Even if it's as I say, at the sacrificing or killing a couple of your heroes and burying a couple of your Vietnams. No, no; don't kill it. But, by golly, just give us the consideration, just give us a few——

Senator CHAFEE. But, how can we? Suppose, let's say, that your section of the Bronx falls outside of the zone?

Mr. MARIOTTA. Oh, my God, my section of the Bronx does not fall out. I am in Fort Apache.

Senator CHAFEE. OK. If you're in Fort Apache, if you're in the area, you'll be all right.

Mr. MARIOTTA. Yes. But what I'm trying to say is, my God, we should also be able to get the full benefit as anybody else coming into the area.

Senator CHAFEE. Well, except these targeted employment tax credits are for 3 years; they're for a limited period. And, presumably, your people have been trained. If you take more people on, then you will get the benefits of it.

Mr. MARIOTTA. Excuse me. Training, here—but what about things and all the blood that we spill on there? I mean, we held the beachhead. In fact, if it wasn't for us, you wouldn't have been able to make this model being able to do. So, we are a living example that this thing can be done without the help that the other big, I say, computer outfits had. And here we are, doing work, and everything else, cheaper than the big conglomerates. I mean, give us a break.

Senator **Chafee**. Well, I see the points you raise. That is an interesting one. Anything else?

Mr. **Mariotta**. No, sir. Thank you. And, finally, we are going in the right direction. By all means, let's go in that direction. I am not here to make it a negative attitude; but listing positive, let's look at the other individuals that are there now.

Senator **Chafee**. OK.

Mr. **Mariotta**. Thank you.

Senator **Chafee**. Thank you very much, Mr. Mariotta.

Mr. Fred Williamson. We welcome you here, Fred.

STATEMENT OF FRED WILLIAMSON, BOARD OF TRUSTEES, NATIONAL TRUST FOR HISTORIC PRESERVATION, WASHINGTON, D.C., AND DIRECTOR, RHODE ISLAND DEPARTMENT OF COMMUNITY AFFAIRS

Mr. **Williamson**. Good afternoon, Senator.

As you know, my name is Fred Williamson, and I'm a trustee of the National Trust for Historic Preservation. As you know, I'm the director of the department of community affairs in the State of Rhode Island. I'm sure you will remember that the organization was established during your third term as Governor of the State of Rhode Island. We feel that that particular group, the department of community affairs, is doing a fine job in the State.

Senator **Chafee**. I'm confident they are, under fine leadership.

Mr. **Williamson**. Thank you, sir.

I'm also the State historic preservation officer and past president of the National Conference of State Historic Preservation Officers. Together with the National Trust, we approve and support the enterprise zone legislation you are presenting; but we also feel that there ought to be in this legislation something in regard to historic preservation.

The National Trust is a national, nonprofit membership organization chartered by Congress in 1949 to lead private sector historic preservation efforts. It is involved on a day-to-day basis with several economic projects such as an Inner-Cities Ventures Fund, a Main Street project, and also rural area projects.

All of these allow the trust and the staff to be involved with neighborhoods, with city planners, and with owners of commercial properties, to the point where we are well aware of the possibilities and economic benefits of historic preservation in regard to the objectives you are seeking in enterprise zones. We feel that historic preservation provides and creates economic opportunities.

You know, historic preservation for some time seemed to have the image of little old gray ladies in tennis shoes, of both sexes. It's not understood that over the years, historic preservation has broadened its scope, and is no longer emphasizing house museums and the similar kinds of enterprises supported in the past.

Historic preservation has been involved, in inner cities, in revitalizing downtown areas and neighborhoods. We feel that enterprise zones are an opportunity to help achieve the complementary goals of historic preservation and urban revitalization, because the enterprise zone concept is consistent with the sensitive, adaptive re-use of older and historic structures. The historic resources of an area should be considered during the zone designation process.

When an enterprise zone is established, there ought to be a resource survey in the beginning accomplished by the State historic preservation officer to identify structures in the zone that are historic and can be utilized as an economic tool.

We would like to make sure that the role of the Advisory Council on Historic Preservation is understood in the zone designation process. It should be specified in the legislation.

We feel that the designation process should not reward localities who abandon their historic preservation ordinances.

In many of the cities throughout the country there are historic district commissions who administer under city ordinances the various sections in those cities concerned with historic preservation.

Throughout the Nation there are thousands of properties on the National Register that are not only individual properties but are also historic districts.

The Economic Recovery Act, if you remember, allowed a 25-percent investment tax credit for structures on the National Register. We hope that the additional 10-percent credit for rehabilitation of zone structures will also be added, to add to the possibility of using historic preservation as an economic tool.

Senator **Chafee**. Well, thank you very much, Mr. Williamson. As you noted, there is the additional 10-percent credit on top of the existing maximum 25 percent.

We will pay attention to the point you made, that in changing regulations or codes, or whatever it is, that one of the things that we should certainly discourage is the overlooking of the Historic Districts in any way that have been incorporated within a city.

Mr. **Williamson**. Sir, over the years our past experience with such things as urban renewal and some other Federal programs have been disastrous in many of the cities of this Nation where there has been a great deal of demolition, and cities no longer, in some places, are recognizable.

Senator **Chafee**. Yes.

Mr. **Williamson**. Historic preservation ought to be looked upon as a real economic tool that should be considered in this legislation.

Senator **Chafee**. I think you are absolutely right, and I agree with you. I appreciate your coming here.

Mr. Panichi?

[No response.]

Senator **Chafee**. I guess he's not here. Mr. Berkowitz?

STATEMENT OF BERNARD BERKOWITZ, PRESIDENT, BALTIMORE ECONOMIC DEVELOPMENT CORP., ON BEHALF OF THE NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT, WASHINGTON, D.C.

Mr. **Berkowitz**. Thank you, Mr. Chairman.

My name is Bernard L. Berkowitz. I am the president of the Baltimore Economic Development Corp. I should say right at the start that as Baltimore City's Economic Development Director I, of course, agree completely with the excellent statement made by Mayor Schaefer, earlier.

But I'm not here speaking on behalf of Baltimore City. I am here as a board member of the National Council for Urban Economic Development, an organization with 1,500 members that plan and implement economic development activities in some 400 cities. Our members include both private sector and public sector persons.

The council is keenly interested in the Enterprise Zone Tax Act. The council in the past has expressed support for the concept of enterprise zones as part of a more comprehensive set of programs to address economic development problems.

While the council has not yet adopted a formal position on S. 2298, I am reasonably confident that the council will support this legislation, with appropriate modifications along the lines that I will discuss in my testimony.

We have submitted written testimony. I have no intention of reading that lengthy testimony but will merely summarize some of the high points of the testimony.

We feel that for private investment to occur in distressed areas of cities that there are a number of ingredients that are necessary.

It is necessary to have land that is sites for commercial and industrial development.

There is a need for adequate infrastructure.

There is a need for affordable financing.

There is a need for a responsive tax system.

There is a need for a trained workforce.

And there must be a public capacity to assist in carrying out that development.

While S. 2298 primarily addresses the responsive tax system ingredient, there is a need for all of the components. Following the guidelines proposed by you, Mr. Chairman, I will not belabor the point regarding the need for continuation of the manpower training, the EDA, the UDAG, and the other useful programs that should be part of a comprehensive approach to the economic development in distressed areas.

The Enterprise Zone Tax Act of 1982 does contain a number of changes that are positive changes as compared to earlier proposals. These include the increase and extension of employee tax credits which focus attention on hiring and training of the economically disadvantaged. I am referring specifically to the 7-year period for such tax credits.

Nevertheless, we feel that along with that there is a need for explicit manpower-training resources and programs, and we would suggest that a program similar to that proposed in H.R. 5527, introduced by Congressmen Garcia and Kemp, should be given consideration as part of the enterprise zone program. That legislation provides explicitly for some resources for manpower training within the enterprise zones.

We feel that the broadening of the scope of State and local participation beyond that of granting tax relief is desirable.

Senator Chafee. I don't think it is restricted to tax relief.

Mr. Williamson. Agreed. What I am pointing out are the positive changes in this legislation as compared to previous proposals, and we think it's desirable that this legislation does provide flexibility with regard to the State and local incentives and participation in the program.

We also think it's desirable that S. 2298 direct attention toward the formulation of viable local development strategies, and the legislation does do that.

There are some remaining concerns which have been touched on by previous speakers. We are concerned about the subject of venture capital, particularly venture capital for small business firms. The legislation, as drawn, does not directly provide any funding for venture capital sources.

Previous legislation, which provided for a 50-percent exclusion of interest income for loans within enterprise zones, would have, through the creation of a tax shelter, encouraged the financing of small new enterprises within enterprise zones, and we would encourage the subcommittee to consider perhaps putting that type of proposal back in the legislation.

We would also support a limited refundability of the tax incentives provided in S. 2298.

We support the proposal that Mr. Norris mentioned in his testimony of expensing of initial investment up to some maximum, and we think that ought to be an option available to firms investing in enterprise zones along with the investment tax credits provided for in S. 2298. That is, firms ought to have the option of either choosing the investment tax credits or expensing up to some maximum.

Senator **Chafee**. All right. Do you want to summarize now?

Mr. **Williamson**. Yes.

We also support Mr. Norris' suggestions that would assist in the provision of important services for new, small enterprises.

We feel that there is some inconsistency between the legislative position and the statements of administration officials with regard to the issue of flexibility in the construction of incentives by local and State governments.

The legislation appears to provide great flexibility, which we support. Some of the statements by administration spokesmen indicate a preference for certain types of incentives over others. We think that it would be desirable for the rules of the game to be spelled out as clearly as possible in terms of the intent of the legislation and that as great degree of flexibility as possible be provided to the local governments.

We are also concerned about the mandated cooperation between State and local governments. We think such cooperation is desirable, should be encouraged, that State incentives should be encouraged. But we oppose a State veto of local applications. Now, I don't personally foresee any problem in Baltimore in achieving cooperation with the State because of the legislation that has been enacted in Maryland, but in other States the timing of such cooperation would present some problems, and probably the obtaining of such cooperation would.

We would suggest that, to simplify this aspect, a certification by the Governor of a State with regard to the State's incentive participation should be sufficient. The Governor, in turn, would base such on his legal ability to provide such certification.

In summary, I would like to reiterate that we appreciate the opportunity of presenting our position to the subcommittee, that the council will be supportive of the legislation with the kinds of modifications that we have suggested.

Senator **Chafee**. Well, thank you very much, Mr. Berkowitz. We appreciate it, and we have had good representation from Baltimore today.

I thank each of you for testifying, for being here.

Thank you.

[The prepared statements of the previous panel follow:]

UNITED STATES SENATE

Subcommittee on Savings, Pensions and Investment Policy

Chairman: Senator John Chafee of Rhode Island

TESTIMONY OF JOHN MARIOTTA, President
Welbilt Electronic Die Corporation
595 Gerard Avenue
Bronx, N. Y. 10451
212 / 993 0500

April 21, 1982
Dirksen Senate Office Building - Room 2227

Thanks for this chance to contribute what I've learned about enterprise in depressed areas. I've learned it doing business for the last 17 years in Fort Apache, the South Bronx.

I and my co-workers have built a going concern in the South Bronx. Sixty employees two years ago. Today, we have 300. Last month we had 350. We had to lay off 50. Welbilt Electronic Die Corporation is a going concern--but sometimes it's hard to know which way we're going, in Fort Apache.

Take this Enterprise Zone Tax Act. When we first heard about it, we thought it was going to do great things for us. After a lot of flipping and flopping we still think so. And I hope you'll translate this powerful idea into powerful fact.

But don't penalize Welbilt and the others who never left the battle zone. Don't penalize the pioneers who led the return. We hold the beach-head, and some of us are even extending that holding. And we're doing it without the supporting tax credits artillery proposed by the Enterprise Zone idea, the E.Z. idea we call it. A fitting label. The Enterprise Zone idea, the E.Z. idea, given a chance will make depressed area economies not E.Z., but at least E.Z.er.

We stayed and expect to stay on--if we can. We stay, although the banks take little risk in Fort Apache. They make no loans unless the loan is guaranteed and the guarantee is guaranteed. Guaranteed by the assets of the borrower and doubly guaranteed by the Government. In the South Bronx, every borrower must learn to eat escrow.

I ask that you give us, who made the first landings, treatment at least equal to that given the 2nd wave, and the 3rd wave, and all the Johnny-come-even-laters during the life of the Enterprise Zone. Don't cut our rations because we were the first to land. Don't treat us worse than the new businesses who get the courage to join us because of Zone benefits. Give us a few of the medals, too. At least, give us even-handed treatment. We have already achieved part of what the newcomer will start trying to achieve. And we did it before the Enterprise Zone and without Enterprise Zone help.

We have already created jobs for unemployed who were thought unemployable. We have already equipped some plants now working in an area abandoned by others. (Our own main factory at Welbilt was dropped by a company that moved to Route 128 near Boston and there fell into Chapter XI.)

Because of companies like us, the Zone will start somewhere above zero. Don't push us back and make us start all over again at zero. It isn't fair and it isn't sound.

Zone benefits must cover companies already in place, struggling to do their job of producing jobs. We're not asking that the benefits be made retroactive to the Year One, to the time we started our enterprises. We ask only that an in-place company get the same considerations, on the same formulae, as those who only now get the courage to join us. While you give them the needle they need, don't give us the shaft. We ask only that you give us the same treatment, even though we're combat veterans who've earned service stripes from the community.

Give us the same tax credits the Johnny-come-later's get--for construction, rehabilitation, investment; the same operating loss carry-over; the same elimination of capital gains taxes.

Failure to achieve this equity threatens accelerated further decay. It will encourage the failure of businesses established in the Zone before its designation. In the '30s people bankrupted their own businesses and bought them back for pennies. This time they would only have to shut down and move like new born babes into another E.Z. (Enterprise Zone) for a relatively low risk high return venture into carpet bagging. We can't afford that.

That's my first point. I have one more.

We need the Enterprise Zone Act. Nothing else has had any major success. Not the Model Cities with their money dispensaries, not the Urban Renewals with their bulldozers. After all the years, we still have the South Bronx, and the South Bronx is a growing community, spreading across the continent. Not evenly. Splotchy.

I'm not an urban expert. But I've lived the story. I can tell you what's here.

We've created a strong company in an area many have deserted. We've taken people off the street, taught them trades they didn't know existed. We've bid competitively on government jobs and commercial jobs and delivered. On time, on spec, on budget--with quality that earns commendations. From the G.E. Aircraft Engine Group. From the Tank Automotive Command. You'll find them and more in the attachments to this testimony.

What we have done can be done on a much larger scale. The Tax Credits of the Enterprise Zone will help a lot. But more can be done--and without more cost to the taxpayer. We can develop an incentive, a marketplace incentive that will bring the needed orders and contracts to the depressed areas--from Government procurement and from commercial buyers.

Just take the savings developed by liberating a person from dependence on Welfare and transfer that saving, proportionately, to the purchasing agency whose order makes the saving happen. And then just see how they'll run to make a deal. We already know the arithmetic. We know it costs $20 to $25-thousand to maintain a family on Welfare. And if a Welfare client, frustrated and discouraged, takes a little drink and lands in jail it costs another $27-thousand to keep him there while the family still has to be supported by the taxpayer.

Transfer the savings to the buying agencies--government and private--and we'll see the orders and the jobs rolling in to get this Enterprise Zone competitive discount.

It can be done. The formula can be sharpened and put to work. This Congress, my Congress, can do it.

Thank you.

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NATIONAL DEFENSE UNIVERSITY
INDUSTRIAL COLLEGE OF THE ARMED FORCES
WASHINGTON, DC 20319

ICAS

Mr. John Mariotta
President
Welbilt Electronics Die Corporation
1049 Washington Avenue - Bronx
New York, New York 10456

Dear Mr. Mariotta:

We are most grateful to you and Mr. Fred Neuberger for the opportunity afforded a group of students and faculty from the Industrial College of the Armed Forces to visit your corporation during their recent visit to New York City. The importance of small business contributions to our economy is included in our educational program, and the students were quite impressed with the operations of your organization.

The group was particularly laudatory of your dedication to progress and the strong work ethic exhibited by you and your employees. The visit with you was most educational and interesting, and provided a better understanding of the small business concern.

Many thanks for an outstanding contribution to our Industrial and Urban Field Studies Program.

Sincerely,

Theodore Antonelli

THEODORE ANTONELLI
Major General, USA
Commandant

DEPARTMENT OF THE ARMY
UNITED STATES ARMY TANK AUTOMOTIVE COMMAND
WARREN, MICHIGAN 48090

DRSTA-I

18 August 1981

Mr. John Mariotta
President
Welbilt Electronic Die Corporation
595 Garard Avenue
Bronx, New York 10451

Dear Mr. Mariotta:

The purpose of this letter is to commend you for your outstanding support and responsiveness to this Command with respect to the cooling kits on the M113 Armored Personnel Carriers. Through your tenacity and responsive efforts, which went well beyond the norm, we were able to solve a major problem in the M113 vehicle system.

I am especially appreciative of your engineering efforts which eliminated the breakage problem we were experiencing on the cooling kit pulleys in its high torque applications. The units you are producing have solved this problem for us. The high quality of your product is testimony of your engineering and production excellence. You can be justly proud of your accomplishments.

Please accept my commendations. I look forward to a continuing excellent relationship with Welbilt.

Sincerely,

Henry B. Jones
HENRY B. JONES
Director of Procurement
and Production

DEFENSE LOGISTICS AGENCY
DEFENSE CONTRACT ADMINISTRATION SERVICES REGION, NEW YORK
60 HUDSON STREET
NEW YORK, NEW YORK 10013

IN REPLY REFER TO DCRN-B

8 March 1978

Mr. John Mariotta
Welbilt Electronic Die Corporation
1049 Washington Avenue
Bronx, New York 10456

Dear Mr. Mariotta:

It gives me great pleasure to commend Welbilt Electronic Die Corporation for outstanding Value Engineering effort.

Welbilt, as a small business, has more limited opportunities for Value Engineering than many larger firms. Nonetheless, Welbilt was successful on its first Value Engineering Change Proposal submitted, recommending a different style rivet for a helicopter exhaust screen, generating savings that will be shared between Welbilt and the Government.

I am sure Value Engineering will continue to receive a high degree of management indorsement at the Welbilt Electronic Die Corporation. I look forward to your continued participation in the DoD Value Engineering Program and future cost savings being generated by your company.

Sincerely,

ROBERT L. HERRIFORD
Brigadier General, USA
Commander

THE ENTREPRENEURS

Tapping Unused Riches in the Slums

By Gerson Goodman

THE ENGLISH LANGUAGE is not exactly the forte of John Mariotta, founder of the Welbilt Electronic Die Corporation in New York City's notorious South Bronx. Born of Puerto Rican immigrants, he had little chance to polish his verbal skills. Still, his business has an annual sales volume of $12 million.

But this is a success story not so much about Welbilt's owner as about Welbilt's workers—ghetto youths and hard-core unemployed who learned a trade and discovered the work ethic.

With odds like those for a snowball in hell, John Mariotta (left) and Fred Neuberger have succeeded in the South Bronx.

Mariotta was 36 when in 1965 he set up Welbilt, his fourth attempt to go into business. Fred Neuberger, now vice president and part owner, was the needed extra ingredient, Mariotta says. An experienced sales engineer, Neuberger brought Welbilt its first big contract, for air filter assemblies for Bell helicopters.

Today, the Welbilt plant stands like a beacon in a sea of residential and industrial deterioration. While remaking society's castoffs into operators capable of running the latest in computerized metalworking machinery, it has become a respected supplier of precision parts and assemblies to the armed forces and the defense industry. The firm has won increasingly larger private and government contracts.

Teaching the unskilled was not a matter of choice, since getting machinists to commute to Welbilt was—and still is—impossible. Job hunters quickly lost interest when they found out where the factory was.

"How are you going to make machinists out of semi-illiterates?" parts buyers for the big corporations would ask him, Mariotta recalls. But he has done it, motivating his workers with the homilies of a Benjamin Franklin rather than the formulas of a Ph.D. in labor relations. Among the doubters that are now convinced are General Electric and TSARCOM (Troop Support and Aviation Readiness Command).

Mariotta still interviews every job applicant. "I tell them, 'You got to work hard. You got to learn.' "

Once he is convinced an applicant can be counted on, he hires on the spot. No effort is made to check references. "What do I care about the past?" he demands. A note of intensity colors his voice. "What if he did commit a crime? Today, right now, he wants to work. That's the only thing that counts."

Mariotta's unorthodox procedures stem from this conviction: Most people abhor idleness. But language and educational deficiencies, not to mention prejudice in hiring, bar some from decent opportunities, he contends.

"Everyone is saying, 'What are we going to do about the South Bronx?' " Mariotta growls. "Everyone is saying, 'You can't teach those so-and-so's anything. You can't get them to come to work on time.' Well, it's not so. I say to them, 'Maybe we have no education, maybe our manners aren't up to par, but this is where it's at between you and me: If you're willing to work, I'll increase your salary.' "

Chico is a good example, Mariotta says. "One morning, in walks Chico with a cigar box under one arm. He says he is working in a hotel, washing dishes. In Mexico he was a mechanic, but here no one will hire him because he doesn't speak English. I ask him what's in the box. He shows me a mike, a 4-inch caliper, two C-clamps and a 6-inch rule. They are all brand-new. I say to myself, if he spent half a week's pay to buy tools, he must really want to learn. So I put him on. When he came to the shop the next morning, he didn't even know how to turn the saw on. But day after day, we stood beside him at the bench till he learned."

The plant, which has never been struck, was organized by the Teamsters in 1974 after peaceful negotiations. "Our relations with the union are extremely cordial," Neuberger observes. "The attitude here is so good that the pilferage and vandalism that plague other industrial enterprises are nearly nonexistent."

Workers who have become supervisors have seen Mariotta fulfill his promises. A bonus arrangement instituted in 1980 pays $1,000 each to first-line supervisors for every $1 million the plant ships. The incentive plan, which added $10,000 to each supervisor's income last year, has also fostered interdepartmental cooperation, Mariotta says.

WHAT THE KIDS he recruited from the streets would have become had there been no Welbilt is a thought that stokes Mariotta's contempt for the nation's multibillion-dollar welfare system. "Everyplace in the U.S. where there is a South Bronx, we have more unused riches than all the Arab oil countries put together," he argues. "Our riches are in our people who want to work. Let the businessmen and the government put factories here where the people are, and you'll see how fast those billions will shrink." □

GERSON GOODMAN *is a New York City-based writer on business subjects.*

TESTIMONY OF FREDERICK WILLIAMSON REGARDING S. 2298
THE ENTERPRISE ZONE TAX ACT OF 1982
ON BEHALF OF
THE NATIONAL TRUST FOR HISTORIC PRESERVATION
BEFORE THE SENATE FINANCE COMMITTEE
SUBCOMMITTEE ON SAVINGS, PENSIONS
AND INVESTMENT POLICY
APRIL 21, 1982

Mr. Chairman and Members of the Committee, my name is Frederick Williamson, and I am a Trustee of the National Trust for Historic Preservation. I am pleased to appear before you today to give you the Trust's views on the proposed enterprise zone legislation, S. 2298.

As you are aware, Mr. Chairman, I am also the Director of the Rhode Island Department of Community Affairs and our state's historic preservation officer. In this position, and through my involvement with the National Conference of State Historic Preservation Officers, I have had the opportunity to observe first-hand the close relationship between historic preservation and urban revitalization efforts. While I appear today on behalf of the National Trust, I bring to the discussion of enterprise zones my many years of experience in urban redevelopment issues.

We support the concept of enterprise zones, and we believe that the principles of preservation may well make a difference in the success of some of these experimental zones. At the same time, we know that enterprise zones are not a substitute for other government programs that encourage community revitalization through direct economic assistance. And, unless we are careful, the lure of another quick economic fix can lead, once again, to the needless destruction of our national heritage at the behest of a sometimes insensitive government.

As you know, Mr. Chairman, the National Trust for Historic Preservation was created by Congress in 1949 to lead private sector preservation efforts in furtherance of our nation's preservation policy. The National Trust has been at the forefront of preservation's evolution from a narrow interest in saving prominent landmarks and historic house museums, to a broad based movement that has a deep concern for the "people issues" involved in the urban and rural built environments. No longer is preservation merely involved with buildings that are historic or pleasing to look at. We are using preservation as a tool for economic growth, neighborhood stabilization, and urban and rural revitalization.

I will not oversell the benefits of preservation. It is not relevant to every community, nor is it a solution for every economic problem. However, in Rhode Island and across the nation, the record of preservation successes lengthens each day. Preservation projects are creating jobs, housing opportunities and business turnarounds. And preservation is not just working in the Georgetowns and Society Hills of this nation. It is working in just those communities that the legislation you are considering today is designed to aid.

Mr. Chairman, the National Trust, is now conducting innovative demonstration programs through its Main Street Center, Inner-City Ventures Fund, and Rural Project. Preservation and neighborhood organizations are working in enterprise zone eligible areas to achieve the complementary goals of revitalization and preservation. Consequently, we feel well qualified to comment on this important legislation.

I must admit that many preservationists have approached the concept of enterprise zones with great caution. Our sometimes bitter experiences with many HUD administered programs, including Model Cities and Urban Renewal, have made us cautious of new programs with great promise but untested impacts. However, we also perceive the great opportunity that this legislation represents to declining communities and to our nation's goal of preserving the best of our historic heritage.

Mutual Goals

Our experience with the tax incentives for the rehabilitation of historic structures, strengthened by the Congress last year, has demonstrated to us the potential of tax incentives to encourage reinvestment in declining areas. We are also buoyed by what we see as a strong consistency between the aims of enterprise zones and the goals of historic preservation. This consistency has been well explored by Dr. Stuart Butler, one of the intellectual fathers of the enterprise zone concept in this country.

In his book, Enterprise Zones, Greenlining the Inner Cities, Dr. Butler states his view that "revitalizing neighborhoods does not mean physically rebuilding them." He urges "a strategy aimed at building a climate, in which people are encouraged to use the latent strengths of an area to take advantage of opportunities that actually exist." He believes that among these inner city strengths are the many older, structurally sound buildings that can form a medium for the growth of small businesses. Dr. Butler espouses a view of reuse and growth for enterprise zone areas, rather than the destructive past policies of mass demolition and new construction.

Consideration of Historic Resources

In order to prevent the needless destruction of historic resources in enterprise zone areas and guarantee that these resources are considered as investment opportunities, we urge that preservation values be considered early during the zone designation process. Unfortunately, the legislation, as written, is "blind" to the historic significance of buildings contained in potential zone areas, and the resource that they represent. Many zone areas, however, are likely to contain important historic resources that may be listed on, or eligible for listing on the National Register of Historic Places. Once listed, properties become eligible for the 25% investment tax credit for rehabilitation provided for under the Economic Recovery Tax Act of 1981. This tax advantage, combined with the enterprise zone investment credit, could be a powerful additional inducement for firms considering locating in a zone.

Beyond this, however, there is a basic need to be sure that there has been an inventory of the historic resources of a potential zone area in order for local, state and federal officials to have a complete picture of an area's latent resources. A comprehensive historic resource survey of a prospective zone area, a relatively inexpensive process that could be conducted by the state's historic preservation officer, should be a prerequisite to zone designation.

For areas that do contain resources that are listed on or eligible for listing on the National Register, the Advisory Council on Historic Preservation and the State Historic Preservation Officer should be involved as consulting parties in the designation process. Under the National Historic Preservation Act of 1966, the Advisory Council is charged with commenting on federal actions that affect historic resources. Because the designation process would be such an action, the Council would have the opportunity to comment. The Congress should clarify the Council's role by formally including it among the list of agencies whose comments will be considered in the zone designation process.

Through Council involvement, the opinions of the state historic preservation officers and the interested public will also be considered. The involvement of the Council, the state preservation officers and the public will not be burdensome. On the contrary, their advice and help will assure that historic resources are wisely utilized to aid the process of zone revitalization and that unnecessary controversies are avoided.

Value of Local Preservation Protections

Even with the active involvement of the Advisory Council and the state preservation officers, the beneficial use of historic resources may still be hindered by shortsighted local action. Localities, in their zeal to present a strong application, may be inclined to offer to relax landmark and historic district ordinances that protect historic resources. While the proposed bill suggests that zoning control of property uses may be one appropriate area for local regulatory relaxation because of its possible hinderance of development, preservation ordinances do not present the same risk.

Historic districts, unlike zoning, do not restrict the use of property or mandate the separation of incompatible uses. Historic preservation ordinances need not stifle development or prevent property from being devoted to its best economic uses. On the contrary, historic districts and ordinances often encourage investment and innovation. Historic structures may be put to a multitide of valuable uses without destroying their historic value.

The creation of local historic districts and preservation ordinances has been encouraged by Congress through the National Historic Preservation Act and through the Federal tax incentives for historic rehabilitations. Government policies should not work at cross purposes. Enterprise zone legislation should not inadvertantly encourage localities to betray our national commitment to preserving our history.

Beyond this, Mr. Chairman, ordinances that express a concern for existing built resources help prevent the type of wholesale demolition and reconstruction that has doomed past urban revitalization programs. The destruction of buildings that could be rehabilitated and reused is a waste of money and energy. The success of enterprise zones depends on the intelligent use of an area's existing resources, including its older and historic structures.

Therefore, we urge the Congress to specify, either in the legislation or in its comments on the legislation, that the relaxation of local preservation ordinances is not an act to be considered favorably by federal officials in considering an area for zone designation.

Relationship to Preservation Tax Incentives

We are most pleased that the legislation you are considering will continue the system of incentives for the rehabilitation of older and historic structures. By proposing an additional 10% tax credit for construction and rehabilitation within enterprise zones, the legislation maintains the margin of tax benefit that makes the rehabilitation of older and historic structures attractive. With the additional 10% credit, historic buildings within enterprise zones will be eligible for a 35% investment tax credit for certified rehabilitation work. This will be a powerful incentive for the reuse of historic resources within a zone. Unfortunately, this tax credit may not prove valuable for smaller, embryonic firms with little or no tax liability against which to take a credit. Consequently, we urge the Committee to consider making the 10% tax credit refundable in cases where a structure has also qualified for the 25% investment tax credit for certified historic structures under the Economic Recovery Tax Act of 1981.

Role of Local Organizations

Finally, Mr. Chairman, we endorse the legislation's attempt to actively involve neighborhood organizations in the enterprise zone experiment. Preservation organizations across the nation are already working to improve their neighborhoods, and community organization leadership is fundamental to the success of our Inner-City Ventures Fund projects.

Not-for-profit community groups are proven providers of low-cost housing units and affordable commercial opportunities. They are able to efficiently employ scarce resources, and any profits are reapplied to community projects. Local organizations enjoy neighborhood support. They understand the entire neighborhood's needs and are not simply oriented toward an individual project. More sensitive to the problems of dislocation, they can design rehabilitation strategies that can accomodate existing tenants and businesses.

A good example of how preservation and urban revitalization can work together has been demonstrated by a non-profit group in Boston, Massachusetts. The Neighborhood Development Corporation of Jamaica Plain, with the assistance of our Inner-City Ventures Fund, plans to rehabilitate an abandoned brewery that is listed on the National Register of Historic Places. Once completed, the former brewery space will provide areas for commercial and industrial business location. The complex is being looked at as a major job creator in a depressed urban area. The rehabilitated complex will provide a variety of spaces for the incubation of fledgling business activity. It will employ both a skilled and unskilled labor force that will be drawn largely from minority and low-income areas.

It is just this type of activity that can take place within an enterprise zone with the involvement of community organizations and the utilization of existing historic resources. I am confident that neighborhood groups, including preservation organizations, will be willing and able participants in the enterprise zone development process.

Fundamentally, this legislation speaks to the need to preserve and enhance the economic and social fabric of our nation's cities and rural areas. Preservationists are already working toward that goal. We bring to this Committee today our belief that the historic areas that our nation, and this Congress, value so highly are, and will be, prime areas of rural and urban enterprise.

STATEMENT OF BERNARD BERKOWITZ
PRESIDENT OF THE BALTIMORE ECONOMIC DEVELOPMENT CORPORATION BALTIMORE, MARYLAND AND MEMBER OF THE BOARD OF DIRECTORS OF THE NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT

BEFORE THE SENATE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

IT IS MY PLEASURE TO BE HERE TODAY TO DISCUSS THE ADMINISTRATION'S ENTERPRISE ZONE PROPOSAL, ITS PRINCIPAL INITIATIVE FOR REVITALIZING THE NATION'S DISTRESSED CITIES. THIS LEGISLATION CONTAINS IMPORTANT INVESTMENT AND JOB GENERATING INCENTIVES WHICH ARE OF GREAT INTEREST TO THE NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT AND ITS MORE THAN 1500 MEMBERS, WHO PLAN AND IMPLEMENT ECONOMIC DEVELOPMENT ACTIVITIES IN MORE THAN 400 CITIES AROUND THE COUNTRY.

PURSUING ITS FREE MARKET APPROACH TO ECONOMIC DEVELOPMENT, THE REAGAN ADMINISTRATION HAS PROPOSED COMBINING FEDERAL TAX CREDITS WITH LOCALLY-DESIGNED INCENTIVE PROGRAMS TO PULL INVESTMENT AND JOBS INTO TARGETED DISTRESSED URBAN AREAS.

ENTERPRISE ZONE INCENTIVES ARE SIMILAR TO A TAX-SIDE ENTITLEMENT PROGRAM. ONCE A FIRM LOCATING WITHIN A ZONE MEETS THE MINIMUM QUALIFICATIONS, IT IS ENTITLED TO THE BENEFITS. THE LACK OF DIRECT FEDERAL CONTROL CONTRASTS SHARPLY WITH OTHER DEVELOPMENT PROGRAMS, IN WHICH THE SIZE OF THE SUBSIDY AND THE EXTENT OF THE ASSISTED ACTIVITY FLOWING TO A PARTICULAR AREA CAN BE REGULATED.

THE ENTERPRISE ZONE PROPOSAL IS FUNDAMENTALLY A TAX PROGRAM AIMED AT PROMOTING URBAN DEVELOPMENT, RATHER THAN A TRADITIONAL ECONOMIC DEVELOPMENT PROGRAM. HOWEVER, THE INGREDIENTS NECESSARY TO FOSTER ECONOMIC REVITALIZATION REMAIN THE SAME.

FOR ECONOMIC DEVELOPMENT TO OCCUR, WHETHER IT BE A SINGLE PROJECT OR AN ENTIRE TARGETED AREA, THE ENVIRONMENT MUST BE CONDUCIVE TO

INVESTMENT. THE COMPONENTS OF THIS ENVIRONMENT, ALL OF WHICH MUST BE PRESENT FOR DEVELOPMENT TO TAKE PLACE, INCLUDE:

- AVAILABILITY OF SUITABLE LAND OR SPACE AT A COMPETITIVE PRICE;
- EXISTENCE OF INFRASTRUCTURE AND OTHER SUPPORTIVE SERVICES;
- A RESPONSIVE TAX SYSTEM;
- A SUITABLY TRAINED WORKFORCE; AND
- PUBLIC SECTOR CAPACITY TO ASSIST DEVELOPMENT.

MOST AREAS FACING DISINVESTMENT ARE LACKING AT LEAST ONE OF THESE ELEMENTS. TAX INCENTIVES ALONE ARE NOT ENOUGH TO ENCOURAGE REVITALIZATION IF OTHER NEEDS MUST BE ADDRESSED AS WELL.

IT IS A COMPLEX COMBINATION OF THESE PHYSICAL, FINANCIAL, AND LABOR COMPONENTS WHICH MAKE AN AREA ATTRACTIVE TO INVESTORS AND ENTREPRENEURS. IN ASSESSING THE POTENTIAL OF ENTERPRISE ZONES TO REVITALIZE DISTRESSED URBAN AREAS, WE MUST NOT NEGLECT THE OTHER ELEMENTS NEEDED FOR PRIVATE INVESTMENT TO OCCUR. FOR ENTERPRISE ZONES TO BE SUCCESSFUL IN IMPROVING THE INVESTMENT ENVIRONMENT, A FLEXIBLE COMBINATION OF SUITABLY TIMED LOCAL INCENTIVES AND APPROPRIATELY COORDINATED PRIVATE ACTIVITIES MUST BE PUT INTO PLACE. ALL LEVELS OF GOVERNMENT MUST NOT LOSE SIGHT OF THE FACT THAT A DELICATE BALANCE OF PUBLIC AND PRIVATE INTERESTS, UNIQUE TO EACH GIVEN AREA, MUST BE REACHED.

ISSUES WHICH THE ADMINISTRATION'S PLAN ADDRESSES

THROUGHOUT DELIBERATIONS OF S1310 AND OTHER PROPOSALS PROMOTING THE ENTERPRISE ZONE CONCEPT OF ECONOMIC DEVELOPMENT, NUMEROUS ISSUES HAVE BEEN RAISED OVER THE EXTENT AND THRUST OF THE FEDERAL INCENTIVES, THEIR COST, AND THEIR IMPACT. THE ADMINISTRATION'S ENTERPRISE ZONE PLAN ATTEMPTS TO ADDRESS A NUMBER OF THESE ISSUES.

JOB OPPORTUNITIES. IN RESTRUCTURING THE ORIGINAL ZONE PROGRAM INCENTIVES, THE ADMINISTRATION HAS PLACED PRINCIPAL EMPHASIS ON DIRECT

JOB-GENERATING INDUCEMENTS. COMPANIES WHICH STAND TO REALIZE THE GREATEST BENEFITS FROM EMPLOYMENT TAX CREDITS, THEREFORE, WILL BE THE LARGER AND MORE LABOR INTENSIVE BUSINESSES AND INDUSTRIES. IN ADDITION, THESE CHANGES WILL STRENGTHEN THE INCENTIVE TO INITIALLY HIRE AND TRAIN ECONOMICALLY DISADVANTAGED PERSONS.

- RAISING THE TAX CREDIT LEVEL TO 50 PERCENT OF WAGES FOR TARGETED GROUPS WILL FOCUS ATTENTION ON HIRING ECONOMICALLY DISADVANTAGED PERSONS, AND IN LARGER NUMBERS.
- EXTENDING THE QUALIFYING TIME FRAME FOR THE CREDITS TO SEVEN YEARS WILL HOPEFULLY ENCOURAGE EMPLOYEE TRAINING BY ZONE FIRMS AND HIRING OF ECONOMICALLY DISADVANTAGED PERSONS INTO CAREER LADDER POSITIONS.

IN ADDITION, THE ADMINISTRATION'S PLAN DIRECTS ATTENTION TO THE PROBLEM OF INDISCRIMINATE WORKER REPLACEMENT IN EXISTING FIRMS AT THE OUTSET OF ZONE DESIGNATION BY BASING THE WAGES SUBJECT TO THE CREDIT ON THE AMOUNT OF TOTAL COMPANY PAYROLL INCREASES WHICH HAVE OCCURRED SINCE THE YEAR BEFORE THE ENTERPRISE ZONE WAS ESTABLISHED.

MINIMIZING ABUSES. THE ADMINISTRATION'S PLAN TRIES TO DEAL WITH SOME OF THE CONCERNS THAT BUSINESSES WOULD USE ENTERPRISE ZONES TO LAUNDER PROFITS FROM PLANTS OUTSIDE OF THE ZONES OR MAKE THEM THE TAX HOME OF PORTABLE CAPITAL EQUIPMENT, WHILE CREATING FEW JOBS OR DOING LITTLE TO AID THE ECONOMIC UPGRADING OF A ZONE AREA. FOR INSTANCE:

- PROPERTY ON WHICH THE ADDITIONAL INVESTMENT TAX CREDIT IS CLAIMED MUST BE USED WITHIN THE ZONE FOR ITS ENTIRE DEPRECIABLE LIFE IN ORDER TO AVOID RECAPTURE OF SOME OR ALL OF THE CREDIT.
- ELIMINATING THE SUGGESTED BUSINESS INCOME TAX EXCLUSION LESSENS THE CHANCES OF ZONES BECOMING HAVENS FOR FIRM SUBSIDIARIES WHICH WOULD SERVE ONLY AS CONDUITS FOR BUSINESS INCOME AND INVENTORY.

STATE AND LOCAL INVOLVEMENT. BY BROADENING THE LOCAL CONTRIBUTION REQUIREMENT OF EARLIER PROPOSALS, THE PLAN DIRECTS ATTENTION TOWARDS THE FORMULATION OF A DEVELOPMENT STRATEGY WHICH MATCHES LOCALIZED NEEDS WITH AVAILABLE STATE AND LOCAL RESOURCES. THE ADMINISTRATION'S PROPOSAL:

- MANDATES STATE AND LOCAL COOPERATION IN DEVELOPING A WORKABLE STRATEGY FOR THE ECONOMIC REVITALIZATION OF THE ZONE AREA;
- BROADENS THE SCOPE OF STATE AND LOCAL CONTRIBUTIONS BEYOND SIMPLY OFFERING TAX RELIEF BY INVITING OTHER FORMS OF INCENTIVES AND COMMITMENTS; AND
- ENCOURAGES DIRECT PARTICIPATION OF PUBLIC AND PRIVATE NEIGHBORHOOD ORGANIZATIONS.

ISSUES REMAINING

THE ADMINISTRATION'S PLAN DOES NOT ADDRESS A NUMBER OF CONCERNS WHICH THE DISCUSSION AND ANALYSIS OF THE CONCEPT OVER THE PAST YEAR HAVE BROUGHT FORTH.

FOR INSTANCE, THE TAX CREDIT EMPHASIS MEANS THAT THE DEGREE OF BUSINESS PROFITABILITY, RATHER THAN TYPE OF ECONOMIC ACTIVITY OR FORM OF INITIAL INVESTMENT, REMAINS THE KEY FACTOR FOR FIRMS TO CONSIDER WHEN DETERMINING THE MAGNITUDE OF POTENTIAL INCENTIVES FOR THEMSELVES. THERE ARE ALSO NO ANTI-RELOCATION DISINCENTIVES TO DISCOURAGE FIRMS FROM SHIFTING EXISTING OPERATIONS FROM OTHER DISTRESSED AREAS OR FROM LOCATIONS WITHIN THE SAME CITY. PROFITABLE FIRMS MAY CONSEQUENTLY RELOCATE TO ZONE AREAS, POTENTIALLY DISRUPTING ECONOMIES IN OTHER AREAS, TO MERELY REFOCUS EXISTING ECONOMIC ACTIVITY RATHER THAN GENERATE NEW GROWTH. CLAIMS THAT EXISTING FIRMS TEND NOT TO RELOCATE NEED TO BE REEXAMINED IN THE FACE OF THE NEW INCENTIVES PRESENT IN THE ENTERPRISE ZONE PROPOSAL. IT WOULD BE POSSIBLE TO BUILD IN SOME DISINCENTIVES TO DISCOURAGE SUCH RELOCATIONS. AN ELABORATE MONITORING SYSTEM WOULD NOT BE REQUIRED.

OTHER TOPICS WHICH THE ADMINISTRATION'S VERSION FAILS TO ADDRESS INCLUDE ACCESS TO CAPITAL AND DIRECT SMALL BUSINESS ASSISTANCE.

ACCESS TO CAPITAL. THE ADMINISTRATION'S PLAN LACKS A MECHANISM TO SPUR SIGNIFICANT VENTURE CAPITAL ASSISTANCE FOR FIRMS LOCATING WITHIN THE ZONES.

- S1310 EXCLUDES FROM FEDERAL TAXATION 50 PERCENT OF ALL INTEREST INCOME EARNED ON LOANS TO ZONE BUSINESSES. THIS WOULD HAVE ESSENTIALLY CREATED A TAX SHELTER AND COULD HAVE ENCOURAGED FINANCIAL INSTITUTIONS AND INDIVIDUALS TO MAKE VENTURE CAPITAL AVAILABLE IN THE ZONES. IT WOULD HAVE ALSO MADE MARGINAL LOANS, LOAN POOLS AND INTEREST RATE REDUCTIONS EASIER TO NEGOTIATE, AND PROVIDED LOCAL ECONOMIC DEVELOPMENT PRACTITIONERS WITH A FLEXIBLE AND USEFUL TOOL. THE ADMINISTRATION DROPPED THIS INCENTIVE IN ITS VERSION. IT SHOULD BE RECONSIDERED.

- THE NEW PROPOSAL MAKES EMPLOYEE AND EMPLOYER TAX CREDITS NON-REFUNDABLE. REFUNDABILITY PROVIDES BUSINESSES WITH A SOURCE OF MONEY WITH WHICH TO BUILD CASH FLOW AND INVEST IN CAPITAL EQUIPMENT. LIMITED REFUNDABILITY WOULD DISCOURAGE ABUSES AND MINIMIZE COSTS WHILE PROVIDING SMALL BUSINESSES WITH A RELIABLE SOURCE OF CAPITAL.

SMALL BUSINESS ASSISTANCE. WHILE IT IS CLEARLY DESIRABLE TO ATTRACT LARGE NEW INDUSTRIES OR BRANCH PLANTS TO THE ZONES, SMALL BUSINESSES ARE ALSO NEEDED IF THEY ARE TO SUCCEED IN REVITALIZING URBAN AREAS. SMALL BUSINESSES PROVIDE NEARLY HALF OF ALL NEW JOBS GENERATED. ALTHOUGH SMALL BUSINESSES ARE OFTEN PIONEERS IN REVITALIZING IN AREA, MANY OF THEM WILL NOT BE ABLE TO COUNT ON A NUMBER OF THE PROPOSED INCENTIVES. TAX CREDITS FAVOR FIRMS WHICH WILL MAKE MONEY FROM THE OUTSET. IT IS QUESTIONABLE WHETHER THE PROPOSED TAX INCENTIVES CAN ACTUALLY ASSIST SMALL BUSINESS DEVELOPMENT. SMALL BUSINESSES NEED UP-FRONT CAPITAL IN THEIR EARLY YEARS DURING WHICH PROFITS ARE MINIMAL AND THE RISK OF FAILURE

IS GREAT. TAX CREDITS DO LITTLE TO HELP BUSINESSES WITH NO TAX LIABILITY; CARRY FORWARD PROVISIONS APPLY MORE TO ESTABLISHED BUSINESSES. THE BILL DOES NOT ADDRESS A NUMBER OF SMALL BUSINESS CONCERNS:

- NO DIRECT JOB TRAINING ASSISTANCE IS OFFERED FOR SMALL BUSINESSES.

- NO MECHANISMS FOR DIRECT SMALL BUSINESS ASSISTANCE ARE PROVIDED; ESPECIALLY IN TIMES OF RECESSION, SUCH FIRMS NEED CASH, NOT TAX CREDITS.

- THE THREE TO TEN PERCENT INVESTMENT TAX CREDIT WILL NOT BE SUFFICIENT IN MANY CASES TO ATTRACT THE NECESSARY CAPITAL INVESTMENTS WHICH EXISTING SMALL BUSINESSES WILL NEED TO IMPROVE THEIR PLANTS AND GROWTH POTENTIAL SO THAT THEY CAN TAKE ADVANTAGE OF OTHER ENTERPRISE ZONE INCENTIVES.

- FEW SMALL BUSINESSES COULD BENEFIT FROM THE ASSURED AVAILABILITY OF INDUSTRIAL DEVELOPMENT BONDS (IDBs). THESE ARE ONLY AVAILABLE TO FIRMS WITH A GOOD CREDIT HISTORY. SUCH BONDS ARE USUALLY FLOATED FOR A MINIMUM OF $250,000 AND ARE GEARED TO LARGER INDUSTRIAL PROJECTS.

FINALLY, RECONDITIONING OR BUILDING INFRASTRUCTURE IN EITHER PUBLIC AREAS OR ON PRIVATE SITES, WHICH IS CRITICAL TO PRIVATE INVESTMENT, COULD BE DIFFICULT FOR CITIES TO PROVIDE IN THIS ERA OF RECESSION AND REDUCED FEDERAL DEVELOPMENT ASSISTANCE.

ISSUES THE ADMINISTRATION'S PLAN RAISES

IN ADDITION TO SPECIFIC FEATURES OF THE BILL, THE ADMINISTRATION HAS, THROUGH WRITTEN PLANS AS WELL AS THROUGH SPOKESPERSONS, PROVIDED SOME INDICATION OF HOW IT WOULD LIKE TO IMPLEMENT THE LEGISLATION. SUCH SUGGESTIONS INCLUDE THE DESIRABILITY OF CERTAIN LOCAL INCENTIVES AND THE AVENUES FOR LEGAL RECOURSE. THEY RAISE A NUMBER OF ISSUES WHICH NEED TO BE EXPLORED.

INTERGOVERNMENTAL RESPONSIBILITIES. THE ADMINISTRATION CLEARLY INTENDS TO FURTHER ITS NEW FEDERALISM INITIATIVE THROUGH THE ENTERPRISE ZONE PROGRAM. CERTAINLY, IT IS DESIRABLE TO ENCOURAGE STATE AND LOCAL COORDINATION IN DEVISING THE METHODS, TECHNIQUES, AND STRATEGIES TO ADDRESS THE ECONOMIC DEVELOPMENT NEEDS OF DISTRESSED AREAS. HOWEVER, THE ADMINISTRATION'S PLAN RAISES A NUMBER OF ISSUES THAT MAY AFFECT A JURISDICTION'S ABILITY TO COMPETE FOR ZONE DESIGNATION.

- THE STATE AND LOCAL COORDINATION NEEDED TO DEVISE THE REQUISITE PACKAGE OF INCENTIVES MAY BE DIFFICULT TO ACHIEVE IN MANY STATES.

- SHORT LEGISLATIVE SESSIONS MAY IMPEDE THEIR DEVELOPMENT. NINETEEN STATES HAVE ANNUAL LEGISLATIVE SESSIONS OF 60 DAYS OR LESS, AND SEVEN HAVE NO REGULARLY SCHEDULED SESSIONS. THIS COMPLICATES THE TIMING OF RESOLUTIONS NECESSARY FOR ZONE DESIGNATION, PARTICULARLY IN THE FIRST ROUND OF COMPETITION.

IN ADDITION, WHEN COORDINATION OF FEDERAL ASSISTANCE SUCH AS UDAG OR CDBG IS INVOLVED, INACTION BY A LEGISLATURE COULD DERAIL THE FEDERALLY FUNDED CONTRIBUTION WHICH A LOCAL GOVERNMENT HAS GARNERED.

- THE SPECIFICS OF STATE PARTICIPATION ARE NOT PROVIDED, RAISING QUESTIONS AS TO THE EXTENT OF STATE PARTICIPATION THAT IS PRATICALLY REQUIRED. FOR INSTANCE, THE TYPE OF ENABLING LEGISLATION TO NOMINATE A ZONE AREA FOR DESIGNATION IS NOT CLEARLY DEFINED. GUARANTEES OF STATE AND LOCAL COMMITMENTS MAY BE DIFFICULT TO OBTAIN, AND THEIR EXTENT IS NOT SPECIFIED.

- POLITICAL DIFFERENCES OR INTRA-STATE RIVALRIES COULD ALSO HARM LOCAL EFFORTS TO GAIN STATE CONCESSIONS ON REGULATORY OR TAX ISSUES.

- LEGAL STEPS WHICH EITHER STATE OR LOCAL GOVERNMENTS COULD PURSUE IF THE OTHER RENEGES ON PROMISED INCENTIVES HAVE NOT BEEN OUTLINED. SIMILARLY, A COURSE OF RELIEF FOR BUSINESSES OR INDIVIDUALS WHO LOSE

BENEFITS IF PROMISED INCENTIVES ARE NOT DELIVERED OR IN CASE OF A ZONE REVOCATION IS NOT PRESCRIBED. THE ADMINISTRATION, IN DISCUSSING ITS PLAN, NOTES THAT ANY OF THESE PERSONS OR ENTITIES WOULD HAVE THE RIGHT TO SUE IN THE EVENT THAT AN ELEMENT OF THE ZONE PACKAGE WAS NOT DELIVERED AS PROMISED.

- THE PROPOSAL IS NOT CLEAR ON HOW HOME RULE CITIES WILL EXERCISE THEIR POWERS IF STATE APPROVAL IS NEEDED FOR DEVELOPING AND GUARANTEEING ZONE INCENTIVES.

SELECTION CRITERIA. BECAUSE THE OTHER ELIGIBILITY CRITERIA ARE LARGELY PERFUNCTORY, THE INCENTIVES AND SERVICES STATE AND LOCAL GOVERNMENTS COMMIT TO THE ENTERPRISE ZONE WILL BE THE KEY ELEMENT IN ZONE DESIGNATION. EACH JURISDICTION WILL HAVE TO SHOW THAT ITS PROPOSED INCENTIVES ADDRESS LOCAL DEVELOPMENT NEEDS AND WILL INDUCE PRIVATE INVESTMENT IN THE ZONE.

THE ADMINISTRATION HAS INSISTED THAT LOCAL FLEXIBILITY AND INITIATIVE FUEL THE DEVELOPMENT OF A TAILORED PACKAGE OF INCENTIVES SUITED TO EACH APPLYING JURISDICTION. THIS NOTWITHSTANDING, ACCORDING TO THE ADMINISTRATION'S PLAN, HUD, IN EVALUATING NOMINATIONS, "WILL IN PARTICULAR EMPHASIZE" THOSE OFFERINGS WHICH PROMOTE A FREE MARKET CLIMATE BY REDUCING GOVERNMENTAL INVOLVEMENT. THESE INCLUDE TAX RELIEF, FROM PROPERTY, SALES, OR INCOME TAX LEVIES, WHEN JURISDICTIONS ARE FISCALLY ABLE; REGULATORY RELEF, FEATURING REVISION, RELAXATION, OR ELIMINATION OF REGULATIONS SUCH AS THOSE GOVERNING ZONING, USURY, PLANNING, OR BUILDING CODES; IMPROVED PUBLIC SERVICES, INCLUDING THEIR PRIVATIZATION; AND CONTRIBUTIONS BY NEIGHBORHOOD AND PRIVATE SECTOR GROUPS, WHICH COULD INCLUDE THE ESTABLISHMENT OF NEIGHBORHOOD ENTERPRISE ASSOCIATIONS.

IF CERTAIN CRITERIA ARE TO BE EMPHASIZED IN THE COMPETITIVE EVALUATION FOR DESIGNATION OF ZONES, THEY NEED TO BE CLEARLY DEFINED. WHILE

FLEXIBILITY IS MENTIONED AS THE GUIDING PRINCIPLE IN DEVELOPMENT LOCAL INCENTIVES, CERTAIN ASPECTS SHOULD NOT IMPLICITLY BE CONSIDERED LESS OR MORE IMPORTANT IN THE EVALUATIVE RANKINGS. COMPLETE PACKAGES WHICH ADDRESS THE TOTAL DEVELOPMENT NEEDS AND EXISTING LEVELS OF EFFORT OF A LOCALITY SHOULD BE CONSIDERED.

THE FOLLOWING COMMENTS ON SOME OF THE SELECTION CRITERIA ARE BASED ON THE ADMINISTRATION'S WRITTEN PLAN.

- THE LOCAL AND STATE TAX RELIEF INCENTIVE CAN RESULT IN SERIOUS LOCAL INEQUITIES FOR BUSINESSES, AND MAY PLACE FISCALLY HEALTHIER CITIES AT A SIGNIFICANT FISCAL ADVANTAGE IN THE COMPETITION.

- PRIVATIZATION OF SERVICES IS GIVEN CONSIDERABLE EMPHASIS. HOWEVER, PRIVATIZATION HAS NOT BEEN UNDERTAKEN ON A SCALE SUFFICIENT FOR CITIES TO DETERMINE WHETHER CONTRACTORS WILL ACTUALLY BE THE BEST WAY TO PROVIDE SERVICES IN A ZONE AREA. FOR EXAMPLE, A ZONE AREA MAY BE TOO SMALL TO ATTRACT PRIVATE FIRMS TO OFFER MOST TYPES OF SERVICES. UNION CONTRACTS WITH VARIOUS GROUPS OF CITY WORKERS MAY PROHIBIT REPLACING CITY CREWS WITH PRIVATE CONTRACTORS.

- THE PLAN DOES NOT ADDRESS THE QUESTION OF HOW EXISTING LEVELS OF SERVICE AND INCENTIVE EFFORTS IN AN AREA WILL BE TREATED IN THE COMPETITIVE PROCESS.

- THE ADMINISTRATION STRONGLY SUGGESTS THE FORMATION OF NEIGHBORHOOD ENTERPRISE ASSOCIATIONS, NOTING THAT TO DO SO WOULD ADD TO THE AREA'S APPEAL FOR DESIGNATION. IT IS NOT CLEAR WHY IT PROPOSES A NEW LOCAL ENTITY, WHICH MAY UNDERMINE THE EFFORTS OF LOCAL DEVELOPMENT CORPORATIONS AND OTHER ORGANIZATIONS ALREADY EXISTING WITHIN THOSE AREAS.

JOB OPPORTUNITIES FOR THE DISADVANTAGED. ALTHOUGH THE PROPOSAL HIGHLIGHTS INCREASING JOB OPPORTUNITIES FOR ECONOMICALLY DISADVANTAGED

PERSONS THROUGH STRENGTHENED INCENTIVES, IT HAS REMOVED THE REQUIREMENT FOR THEIR EMPLOYMENT AS A CONDITION WHICH MUST BE MET BEFORE A FIRM COULD QUALIFY FOR ANY OF THE FEDERAL ENTERPRISE ZONE BENEFITS. EARLIER PROPOSALS CALLED FOR MINIMUM PERCENTAGE THRESHHOLDS OF NEW HIRES FROM THE RANKS OF THE ECONOMICALLY DISADVANTAGED, FOR BOTH NEW AND EXISTING BUSINESSES WITHIN THE ZONES. UNDER THE ADMINISTRATION'S PLAN, OPERATIONS SUCH AS WAREHOUSING, WHICH CREATE FEW JOBS, OR HIGH TECHNOLOGY COMPANIES, WHICH WOULD GENERATE FEW JOBS FOR THE UNSKILLED--BUT WHO WOULD FIND THE OTHER INCENTIVES ATTRACTIVE--MAY MOVE INTO ZONES AND PHYSICALLY CROWD OUT FIRMS THAT WOULD BE MORE SUITED FOR ASSISTING THE ZONE AREA AND ITS RESIDENTS. A REQUIREMENT FOR HIRING CERTAIN LEVELS OF DISADVANTAGED PERSONS WOULD BE DIFFICULT TO ADMINISTER AND ONEROUS ESPECIALLY FOR SMALL BUSINESSES. HOWEVER, EVERY EFFORT SHOULD BE MADE THROUGH FEDERAL, STATE, AND LOCAL TRAINING PROGRAMS TO PROVIDE ADEQUATE JOB OPPORTUNITIES FOR UNEMPLOYFD AND UNDER-EMPLOYED PERSONS IN ENTERPRISE ZONES.

OUTLOOK

AS WITH SIMILAR PROPOSALS, THE EVENTUAL IMPACT OF ENTERPRISE ZONE INCENTIVES ON REBUILDING THE ECONOMIES OF TARGETED URBAN AREAS REMAINS UNKNOWN. VARIABLES SUCH AS THE LOCAL CONTRIBUTION PACKAGE, THE EXISTING ECONOMIC, PHYSICAL, AND SOCIAL CONDITION OF THE ZONE, THE TYPES OF BUSINESSES LOCATING WITHIN THE DESIGNATED AREA, AND OTHERS WILL VARY WIDELY FROM CITY TO CITY. THUS, THE ABILITY TO PREDICT ANY GENERAL RESULTS OF ESTABLISHING ENTERPRISE ZONES IS IMPOSSIBLE. NEVERTHELESS, THE LEGISLATION COULD SPARK MORE STATE-LOCAL COOPERATION IN PINPOINTING SPECIFIC LOCAL DEVELOPMENT NEEDS AND ASSESSING THE SCOPE OF STATE AND LOCAL RESOURCES AVAILABLE FOR THAT DEVELOPMENT.

ON BEHALF OF THE NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT, I THANK YOU FOR THIS OPPORTUNITY TO TESTIFY. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Senator Chafee. Mr. Chaikin, who has been very patient—or maybe impatient.

Now, you can summarize, or do whatever you wish.

STATEMENT OF SOL C. CHAIKIN, PRESIDENT, INTERNATIONAL LADIES' GARMENT WORKERS' UNION, NEW YORK, N.Y., FOR ILGWU AND THE AFL-CIO, WASHINGTON, D.C.

Mr. Chaikin. Senator, I thank you for the opportunity of appearing before you. With your permission, I would like to read the statement put together by the International Ladies' Garment Workers' Union, working cooperatively with the AFL-CIO. It's of no great length.

Senator Chafee. Is this the summary or the statement itself.

Mr. Chaikin. No; the statement itself, sir.

Senator Chafee. All right. Well——

Mr. Chaikin. I would like to introduce at the outset Evelyn Dubrow, whom you know, who is our legislative director in Washington; to my right, Herman Starobin, the director of research of the ILGWU; and Arnold Cantor, the associate director of the research department of the AFL-CIO.

Sir, I am pleased to have this opportunity to appear before you today to present the views of organized labor in opposition to President Reagan's proposal to establish enterprise zones. I am here in a dual capacity—as vice president and a member of the executive council of the AFL-CIO, and as president of the International Ladies' Garment Workers' Union. Attached to my testimony is a letter from the AFL-CIO which spells out to all Members of Congress the federation's opposition to this program, and I ask that it be made part of the record as well.

The basic premise of the President's message and the proposed legislation is essentially the same. It is that incentives to business to invest in economically depressed areas through tax abatement and exclusive reliance upon private sector institutions will lead to the creation of new jobs in these areas. The program, we are told, is a fresh approach to arresting and reversing impoverishment and decay in the inner cities and in promoting economic growth thereby removing Government barriers. In the President's words, it would lead to freeing individuals to create, produce, and earn their own wages and profits. Note how reminiscent these claims are to the supply side propaganda and promises we were treated to a year ago.

It is now patently clear—if it had not been so a year ago—that the size, form, and content of the Reagan tax cut and other supply-side measures not only failed to accomplish their professed claims, including the creation of new jobs, but have moved the economy in the opposite direction. They have intensifed the economic difficulties of the Nation. Yet, we are again being offered much of the same philosophy as the way to deal with the Nation's urban crisis.

This time there is an additional twist whereby, behind the facade of a New Federalism, States and localities are also to join in the process of cutting taxes, setting aside local regulations, and other alleged Government impediments to the rebirth of blighted areas.

In short, this Nation is again being asked to swallow more of the same, with the addition of new pressures on already financially overburdened States and localities which are even now unable to meet the needs of their citizens.

It is a matter of general knowledge that the administration originally planned to propose elimination or modification of the minimum wage as part of the enterprise zone notion. After examining the history of the idea and identifying some of its advocates, we suspect that the lifting of regulations that protect public health, provide for occupational safety, and attempt to limit further degradation of the environment remain as part of the hidden agenda.

That this is, in fact, the case is indicated by the public views of one of the administration's mentors on enterprise zones, the Heritage Foundation. Drawing in large part upon the program elaborated by the Thatcher government in Great Britain, the Heritage Foundation's expert on enterprise zones proposes eliminating or reducing minimum wage requirements, relaxing local zoning provisions, easing building code restrictions, ending rent controls, and so on. All this, of course, in the name of creating new jobs.

I cannot help but observe the obvious elements of tragedy and farce in the origins of this proposal. Great Britain's Conservative Party has been engaged for 3 years in an economic experiment combining elements of monetary restraint, Milton Friedman's free market philosophy, and supply-side economics. After 15 months of Reaganomics and the rapidly growing economic failure it has brought with it, we are now being asked to adopt additional approaches that are part and parcel of Great Britain's misdirected policies. And, we are told by the conservative Heritage Foundation, let's try it, there's little to lose.

There is a mystical belief embodied in the President's proposal as to how jobs are created generally and particularly by small business. I know small business well; it characterizes the industry in which the members of our union work.

There should be no mystery as to why and under what circumstances businessmen invest. One thing is certain: they do not invest because it is a good thing to do. They invest for profit. Their hope is to sell everything they make at a price which leaves them in the black. Businessmen expand production when demand for their goods is greater than their capacity and in recognition of the fact that under such circumstances increased capacity will lead to increased sales and profits.

It is no great secret that capacity usage as a whole in our consumer-oriented economy is currently running around 70 percent. What inducement is there for businessmen to invest under these circumstances? Where is the inducement to increase production when a minimum of 9 percent of the work force, and as many as 12.5 percent—when discouraged workers and those working part-time but who wish to work full-time are included—are idled as a result of the administration's economic policies? Where is the inducement to invest when a psychological climate of fear, based on current economic realities, buttressed by the massive increase of small business failures, pervades the Nation?

The stress in the President's proposal and in legislation introduced into the Congress, as well as on the part of the conservative think tank that imported the proposal from Great Britain, is on encouraging small business to invest in enterprise zones and on the expansion of labor-intensive employment. I can tell you straight out that if this does happen in one major labor-intensive industry, apparel, it will come at the expense of jobs now existing outside of the enterprise zone.

Over the past two decades hundreds of thousands of jobs have been lost in my industry as a result of the rapid increase in apparel imports. Many additional jobs have been lost in legitimate shops as a result of the proliferation of employment of undocumented workers who, because of their status, are forced to work in shops operated by unscrupulous businessmen and where the basic laws that protect workers, especially minimum wages, hours, and working conditions, are constantly violated.

The ongoing decline in this industry is shown by the fact that average employment of production workers in 1981 was 14.4 percent below its 1973 peak. Comparing production worker employment in February 1982 with the same month in 1973, the decline is 19 percent. A BLS analysis in 1978 projected a growth of less than 1 percent a year through 1980. Even this minuscule growth projection was overoptimistic. As a result, creation of new apparel jobs in any geographic area in this country must, unavoidably, lead to a decline elsewhere.

There are few ties to bind labor-intensive industries to a given area. Raw materials and power supplies are not major factors. The chief requirement is an abundant labor supply that can be given the brief training most jobs in such industries require. Small scale and low capitalization make such industries among the most mobile. At the same time, they are a key source of employment for members of minority groups, for women, and for recent immigrants—many with language problems. Large numbers of small scale labor-intensive industries, including apparel plants, already exist in the distressed urban areas the proposed legislation purports to aid. They are there because the labor supply they need is there.

The proposed legislation would not create any new jobs but, at most, merely shift existing jobs from one depressed area to another and from one minority group to another. This would be particularly encouraged in labor-intensive industries, including apparel, where firms can, with relative ease, move from location to location to exploit tax breaks without creating any additional jobs. This is especially true of the tax provisions in the President's proposal that call for a 10-percent tax credit to employers for wages paid to zone employees over and above the payroll paid such employees in the year prior to zone designation, the proposal to eliminate capital gains on zone property, and the increased investment tax credit.

Because wages constitute a controllable cost, they are the prime area in which domestic labor-intensive industries can compete in an open market with imports. Yet, by manufacturing standards in this country, wages in the apparel industry, for example, average across the country $5 to $5.50 per hour. With benefits, this comes to total compensation of about $6.75 an hour. Workers in the major exporting countries earn a minute part of this amount—less than a dollar in Hong Kong, less than 40 cents per hour in Taiwan, Korea, or Singapore, about 20 cents an hour in India, even less in Sri Lanka and the Peoples' Republic of China.

In apparel and other labor-intensive industries, now an important source of jobs in the inner city, an increase in jobs can only result from lowering present workers' income in order to compete with wages paid to workers in Asian countries or with undocumented workers whose wage levels are not protected. Is this the kind of solution to the urban blight and to the desperate need for employment that proponents of enterprise zones are recommending?

The proposed legislation also ignores the need for attention to basic requirements in areas referred to as potential candidates for enterprise zones. They include improved sanitation, health care facilities, crime, drug and alcohol prevention, and housing. The proponents of the program apparently assume that, by some magical process, all these elements would suddenly appear if the proposed program becomes law.

It is obvious that each impoverished and disadvantaged community seeking assistance under the enterprise zone program would, in essence, compete with a similarly deprived community in order to attract firms. Free enterprise would come to consist of destructive competition for giveaways. This would inevitably lead to further erosion of area tax bases and community services facilities. Contrary to the claims of the legislation's proponents, the urban enterprise zone program must lead to further declines in living standards and in increased segregation of poverty areas.

We have seen this happen in many parts of the world where so-called "enterprising" employers have come into an area of large-scale unemployment, set up operations, and, after sucking the area dry, moved on to greener pastures. We have witnessed over and over again examples where labor-intensive industries make use of a large labor pool to play workers off against each other for the limited employment available. Workers are forced to compete for wages and for the conditions under which they work. It is not at all difficult to find such labor pools in distressed areas.

Neither the President nor sponsors of enterprise zone legislation anticipate that such capital-intensive companies as General Motors or IBM will invest in enterprise zones.

The lure of quick profits, minimal investment, and tax abatements will, however, encourage fly-by-night and speculative employers. Their concern is primarily with the weakening of protective legislation, particularly necessary in the case of labor-intensive work, in order to maximize profits. The proponents of the enterprise zones are, in essence, encouraging the weakening of such legislation for workers in the zone and for the community as a whole.

The principal beneficiaries of this new tax giveaway would be the more footloose firms which could take advantage of the tax breaks offered. Additionally, a firm outside the zone which employed residents of a zone would receive no benefits. Aside from the inequities created, the tax provisions contained in the proposal would provide incentives for shut-downs outside the zones and relocations into the zones.

The labor movement strongly favors the rebuilding of our inner cities and the creation of new jobs. We are convinced, however, that, to be effective, a coordinated national economic program is needed, one that would involve all sectors of the economy and make use of all the tools at the disposal of Government.

Growth in economic activity and development in the United States has always depended upon an adequate, expanding stock of private and public capital facilities that complement each other. Public highways and ports, streets and bridges are necessary for movement of the private truckloads and shiploads of industry products. Mass transit systems are of increasing importance in an age of energy scarcity. Water supply and sewage collection systems are essential for everyday living functions of populations in urban centers as well as to support the ongoing economic activities.

This Nation cannot afford to continue to grant further tax advantages to the business community while sloughing off the responsibilities of national government to the States. As presently contemplated, urban enterprise zone legislation is a delusion and a diversion from the real problems facing our inner cities. We are convinced it is part of a broader, sugar-coated strategy aimed at the destruction of hard-won protective legislation for the workers and the poor of our Nation, organized and unorganized, a weakening of organized labor, and additional giveaways to the business community without requiring any reciprocity to the Nation as a whole.

Mr. Chairman, the AFL-CIO has long argued for specific, targeted approaches to job creation, inner-city revitalization, and reindustrialization. This past February the Executive Council designed a far-reaching and comprehensive economic alternative to the Reagan economic program. The AFL-CIO alternative offers the most effective way to deal with our blighted inner cities and the high levels of unemployment that pervade them. It addressed in detail how to set the Nation on a path of economic recovery, full employment, and balanced economic growth. And, it adds up to a call for 180-degree reversal of the economic policies of this administration. A copy of the February Council statement is attached, and I ask that it be placed in the record.

In addition, Senator Chafee, the Foreign Affairs quarterly has just published an article which I presented to them in the Spring—1982 edition, entitled "Trade Investment and Deindustrialization: Myth and Reality." I ask leave that this article, too, be appended and attached to the record.

Senator Chafee. Well, Mr. Chaikin, we have got to draw the limit somewhere, and what will go in the record—I don't know how long the article is, but it will be available. Let me check out the size of it. But the rest of your requests we will comply with, and we appreciate your statement.

Let me just say this. On page 2 of your statement, "In short, this Nation is again being asked to swallow more of the same, with the addition of new pressures on already financially overburdened States and localities who are even now unable to meet the needs of their citizens." Well, that is the view which you expressed, but there has not been a single Governor or a single mayor, who are the people who are on the firing line, having to meet these burdens, who has come in here and testified against it. Indeed, they have come in and testified for it. You have heard them.

You have been here most of the day. The list of witnesses, whether it is the mayor of Baltimore, Mayor Schaefer, or whether it is Governor Orr of Indiana, or Governor Brown of Kentucky—and so it goes.

Mr. CHAIKIN. May I suggest, Senator, that whatever motivates them or impels them to come before this body to testify for enterprise zones, it is my judgment that they haven't thought this thing through very carefully. And I would advise as well, Senator Chafee, that you think it through. I spent many years in your State.

If a company making ladies apparel in West Warwick learned that Providence itself or a section in Providence were to be designated as an enterprise zone and could be the beneficiary of all of the goodies that are not only contained in this legislation but which may be attached to the legislation during debate and before passage, would that company not move over, if it is in as highly mobile an industry as ours where two mechanics with screwdrivers and a trailer truck can move a factory employing 50 or 60 people in a matter of hours from one location to another, especially locations that are so contiguous?

How would you handle a situation if you designated the South Bronx as an enterprise zone, with tens of thousands of Hispanics and blacks working in Manhattan, working outside of the South Bronx and the North Bronx? How would you prevent relocation and the transfer of unemployment within the same ethnic and minority groups which you ostensibly wish to help? Unless you made all of New York City an enterprise zone, unless you made all of the State of Rhode Island an enterprise zone, how could you keep a factory in Danielson, Conn., when it would be of such advantage to that owner to move that plant from Danielson into an enterprise zone in Providence, R.I.?

All you would be doing is exchanging employment in one area for employment in another area, and not too successfully at that.

I challenge any Governor, I challenge any mayor, who may be terribly concerned with the circumstances in his or her own State, who may be terribly concerned with the situation in his or her own local community to tell me how this would add up to additional general employment in the United States of America.

Senator CHAFEE. I take a little different view.

First of all, I think the points you raised are valid points and that they are matters we should worry about as we consider this legislation. And I'm glad you have presented them. You have been the heavy in today's performance. Everybody else has been lyrical in favor of it. You have come in with a different view, and it's very helpful. I appreciate it.

But I don't subscribe to your view that there are *x* number of jobs in the United States, and if there are *x* number of jobs available for our people, and if you make it more attractive to be one place, then people will rush in there, and that takes jobs from another place. I mean, the whole concept of the United States is that it's an ever-increasing and expanding job system. There may not be a growth of jobs in your particular industry, but, overall, we have constantly increased the number of jobs in the United States.

It's true, as you point out here, that we are going through a decline now, but we are looking for the long haul. It is my view that we are going to continue this increase.

Mr. CHAIKIN. Senator, if the United States of America embarked on a program of giving back, of lessening the tax liabilities and the responsibilities of industry in an industrial democracy, I don't think that you would be doing anything except lowering the standard of living of the American people, that you would not provide the funds necessary to maintain and improve the infrastructure of a civilized society in the United States.

All of us look forward to job growth. All of us look forward to job growth which has a healthy basis, and not the job growth on the basis of saying to an employer, "Come here and pay your workers less. Come here and don't confront your fair share of the tax burden."

Senator CHAFEE. Wait a minute. There is nothing in here about paying your workers less. The workers end up with the exact same salary.

Mr. CHAIKIN. I am using a hypothetical circumstance. It is on a par with the suggestions that you make. You say to employers "Come here and pay fewer taxes. Come here and the capitalists who invest in venture capital in these zones will not have to pay the true tax on the income they derive. Come here and if you manage to eke out a capital gain you will not have to pay taxes on the capital gain." It's all of a piece.

People move from one area to another because of advantages in labor, because of advantages perhaps in the environment, perhaps because of other advantages in tax abatements and tax breaks. No, that way lies disaster, because everybody will be competing for the goodies, and the rest of us will not hold up our end.

For example, one of the worst features—and this is something that I think you lived through as a resident of Rhode Island, as did thousands of our members in Rhode Island. You used to have a very thriving textile industry. It was lured away. It was stolen away from Rhode Island by other communities that competed against Rhode Island on the basis of abatements, on the basis of labor circumstances, on the basis of a political and social environment more conducive to the captains of industry who formerly populated your State.

Now, you are going to bring it down to an even more intimate level. You are now going to set city against city. You are going to have 25 enterprise zones designated. They are going to be nominated by mayors and Governors. The Secretary of HUD is going to choose the ones that will be designated as enterprise zones. And if I am an employer outside the enterprise zone, I will come to the mayor of my community or the Governor of my State and say, "I can move to that enterprise zone across the border. I don't know whether I would really like to do it, but what are you willing to do for me if I stay?"

So there will be a competition not only to get into the enterprise zone, if a labor-intensive industry wants to move, but a competition to keep the presently engaged labor-intensive industry where it is.

Senator CHAFEE. OK.

Mr. CHAIKIN. I think that's very hazardous for us.

Senator Chafee. I see the point you have made, and I see the problems, as you point out, of the particular industry you were associated with. I am familiar with it. I have campaigned in garment factories and then have come back 2 weeks later and found the whole place empty, gone, a step ahead of the sheriff. So I know what you are talking about, and it's a point that we will have to bear in mind.

Mr. Chaikin. Senator, I am sorry that I spent so much time referring to my own industry. I have some knowledge of it, and a great deal of my life has been spent in it. But what I say about the manufacture of apparel holds just as true for other labor-intensive industries which employ in this country upward of 10 million American workers. I don't want you to think in my opposition to this bill that it is constructed so narrowly, and that I am such a sectarian and parochial spokesman. There are well over 10 million workers involved in small business—heavily overburdened, heavily competitive, labor-intensive, highly mobile. By definition, "labor-intensive" means just that. Instead of having machinery that costs $75,000 or $150,000 to keep one worker employed, it has minimal—minimal—investment in machinery. That machinery is light, easily transportable, easily installed. So it is not just apparel that I am discussing.

Senator Chafee. All right. Fine.

I appreciate your testimony, Mr. Chaikin, and your patience, and that of Evie and others who are with you. So, thank you very much.

Mr. Chaikin. And thank you very much, Senator

[Mr. Chaikin's prepared statement and other materials follow:]

STATEMENT OF SOL. C. CHAIKIN, VICE PRESIDENT AMERICAN FEDERATION OF LABOR & CONGRESS OF INDUSTRIAL ORGANIZATIONS, PRESIDENT, INTERNATIONAL LADIES' GARMENT WORKERS' UNION, BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY OF THE SENATE COMMITTEE ON FINANCE ON S. 2298 THE ENTERPRISE ZONE ACT OF 1982

April 21, 1982

I am pleased to have this opportunity to appear before you today to present the views of organized labor in opposition to President Reagan's proposal to establish enterprise zones. I am here in a dual capacity -- as Vice President and member of the Executive Council of the AFL-CIO and as President of the International Ladies' Garment Workers' Union.

Attached to my testimony is a letter from the AFL-CIO which spells out to all Members of Congress the Federation's opposition to this program. I ask that it be made part of the record.

The basic premise of the President's message and of proposed legislation is essentially the same. It is that incentives to business to invest in economically depressed areas through tax abatement and exclusive reliance upon private sector institutions will lead to the creation of new jobs in these areas. The program, we are told, is a "fresh approach" to arresting and reversing impoverishment and decay in the inner cities and promoting economic growth there by removing government barriers. In the President's words, it would lead to "freeing individuals to create, produce and earn their own wages and profits." Note how reminiscent these claims are to the "supply side" propaganda and promises we were treated to a year ago.

It is now patently clear -- if it has not been so a year ago -- that the size, form and content of the Reagan tax cut and other "supply side" measures not only failed to accomplish their professed claims, including the creation of new jobs, but have moved the economy in the opposite direction. They have intensified the economic difficulties of the nation. Yet, we are again being offered much of the same philosophy as the way to deal with the nation's urban crisis. This time there is an additional twist whereby behind the facade of a "New Federalism," states and localities are also to join in the process of cutting taxes, setting aside local regulations and other alleged government impediments to the rebirth of blighted areas. In short, this nation is again being asked to swallow more of the same -- with the addition of new pressures on already financially overburdened states and localities, which are even now unable to meet the needs of their citizens.

It is a matter of general knowledge that the Administration originally planned to propose elimination or modification of the minimum wage as part of the enterprise zone notion. And, after examining the history of the idea and identifying some of its advocates we suspect that the lifting of regulations that protect public health, provide for occupational safety and attempt to limit further degradation of the environment remain as part of the hidden agenda. That this is, in fact the case is indicated by the public views of one of the Administration's mentors on enterprise zones, The Heritage Foundation. Drawing in large part upon the program elaborated by the Thatcher government in Great Britain, the Heritage

Foundation's expert on enterprise zones proposes eliminating or reducing minimum wage requirements, relaxing local zoning provisions, easing building code restrictions, ending rent controls and so on. All this, of course, in the name of creating new jobs.

I cannot help but observe the obvious elements of tragedy and farce in the origins of this proposal. Great Britain's conservative party has been engaged for three years in an economic experiment combining elements of monetary restraint, Milton Friedman's free market philosophy and supply side economics. After fifteen months of Reaganomics and the rapidly growing economic failure it has brought with it, we are now being asked to adopt additional approaches that are part and parcel of Great Britain's misdirected policies. And, we are told, by the conservative Heritage Foundation, let's try it, there's little to lose.

There is a mystical belief embodied in the President's proposal as to how jobs are created generally and particularly by small business. I know small business well; it characterizes the industry in which the members of our union work.

There should be no mystery as to why and under what circumstances businessmen invest. One thing is certain: they do not invest because it is a "good" thing to do. They invest for profit. Their hope is to sell everything they make at a price which leaves them in the black. Businessmen expand production when demand for their goods is greater than their capacity and in recognition of the obvious fact that under such circumstances increased capacity will lead to increased sales and profits.

It is no great secret that capacity usage as a whole in our consumer-oriented economy is currently running around 70 percent. What inducement is there for businessmen to invest under these circumstances? Where is the inducement to increase production when a minimum of 9 percent of the workforce, and as many as 12.5 percent (when discouraged workers and those working part-time but who wish to work full-time are included) are idled as a result of the Administration's economic policies? Where is the inducement to invest when a psychological climate of fear, based on current economic realities buttressed by the massive increase of small business failures, pervades the nation?

The stress in the President's proposal and in legislation introduced into the Congress, as well as on the part of the conservative "think tank" that imported the proposal from Great Britain, is on encouraging small business to invest in enterprise zones and on the expansion of labor-intensive employment. I can tell you straight out that if this does happen in one major labor-intensive industry, apparel, it will come at the expense of jobs now existing outside of the enterprise zone.

Over the past two decades hundreds of thousands of jobs have been lost in my industry as a result of the rapid increase in apparel imports. Many additional jobs have been lost in legitimate shops as a result of the proliferation of employment of undocumented workers who, because of their status, are forced to work in shops operated by unscrupulous businessmen and where the basic laws that protect workers, especially minimum wages, hours and working conditions, are constantly violated.

The ongoing decline in this industry is shown by the fact that average employment of production workers in 1981 was 14.4 percent below its 1973 peak. Comparing production worker employment in February, 1982 with the same month in 1973, the decline is 19.0 percent. A Bureau of Labor Statistics analysis in 1978 projected a growth of less than 1 percent a year through 1980. Even this miniscule growth projection is probably overoptimistic. As a result, creation of new apparel jobs in any geographic area in this country must, unavoidably, lead to a decline elsewhere.

There are few ties to bind labor-intensive industries to a given area. Raw materials and power supplies are not major factors. The chief requirement is an abundant labor supply that can be given the brief training most jobs in such industries require. Small scale and low capitalization must make such industries among the most mobile. At the same time, they are a key source of employment for members of minority groups, for women and for recent immigrants, many with language problems. Large numbers of small scale labor-intensive industries, including apparel plants, already exist in the distressed urban areas the proposed legislation purports to aid. They are there because the labor supply they need is there.

The proposed legislation would not create any new jobs, but, at most, merely shift existing jobs from one depressed area to another and from one minority group to another. This would be particularly encouraged in labor intensive industries, including apparel, where firms can, with relative ease, move from location to location to exploit tax breaks without creating any additional jobs. This is especially true of the tax provisions in the President's proposal that call for a 10 percent tax credit to employers for wages paid to zone employees over and above payroll paid such employees in the year prior to zone designation the proposal to eliminate capital gains tax on zone property and the increased investment tax credit.

Because wages constitute a "controllable" cost, they are the prime area in which domestic labor intensive industries, can compete in an open market with imports. Yet, by manufacturing standards in this country, wages in the apparel industry, for example, average across the country \$5 to \$5.50 per hour. With benefits, this comes to total compensation of about \$6.75 an hour. Workers in the major exporting countries earn a minute part of this amount -- less than \$1 per hour in Hong Kong, less than 40¢ an hour in Taiwan, Korea or Singapore, about 20¢ in India and even less in Sri Lanka and the Peoples' Republic of China.

In apparel and other labor intensive industries, now an important source of jobs in the inner city, an increase in jobs can only result from lowering present workers' income in order to compete with wages paid to workers in Asian countries or with undocumented workers whose wage levels are not protected. Is this the kind of solution to the urban blight and to the desperate need for employment that the proponents of enterprise zones are recommending?

The proposed legislation also ignores the need for attention to basic requirements in areas referred to as potential candidates for enterprise zones. They include improved sanitation, health care facilities, crime, drug and alcohol prevention and housing.

The proponents of the program apparently assume that, by some magical process, all these elements would suddenly appear if the proposed program becomes law.

It is obvious that each impoverished and disadvantaged community seeking assistance under the enterprise zone program would, in essence, compete with a similarly deprived community in order to attract firms. Free enterprise would come to consist of destructive competition for giveaways. This would inevitably lead to further erosion of area tax bases and community services facilities. Contrary to the claims of the legislation's proponents, the urban enterprise zone program must lead to further declines in living standards and in increased segregation of poverty areas.

We have seen this happen in many parts of the world where so-called "enterprising" employers have come into an area of large-scale unemployment, set up operations and, after sucking the area dry, moved on to greener pastures. We have witnessed over and over again examples where labor-intensive industries make use of a large labor pool to play workers off against each other for the limited employment available. Workers are forced to compete for wages and for the conditions under which they work. It is not at all difficult to find such labor pools in distressed areas.

Neither the President nor sponsors of enterprise zone legislation anticipate that such capital intensive companies as General Motors or IBM will invest in enterprise zones.

The lure of quick profits, minimal investment and tax abatements will, however, encourage fly-by-night and speculative employers. Their concern is primarily with the weakening of protective legislation, particularly necessary in the case of labor-intensive work, in order to maximize profits. The proponents of the enterprise zones are, in essence, encouraging the weakening of such legislation for workers in the zone and for the community as a whole.

The principal beneficiaries of this new tax giveaway would be the more footloose firms which could take advantage of the tax breaks offered. Additionally, a firm outside the zone which employed residents of a zone would receive no benefits. Aside from the inequities created, the tax provisions contained in the proposal would provide incentives for shutdowns outside the zones and relocations into the zones.

The labor movement strongly favors the rebuilding of our inner cities and the creation of new jobs. We are convined, however, that, to be effective, a coordinated national economic program is needed, one that would involve all sectors of the economy and make use of all the tools at the disposal of government.

Growth in economic activity and development in the United States has always depended upon an adequate, expanding stock of private and public capital facilities that complement each other. Public highways and ports, streets and bridges are necessary for movement of the private truckloads and shiploads of industry products. Mass transit systems are of increasing importance in an age of energy scarcity. Water supply and sewage collection systems are essential for everyday living functions of populations in urban centers as well as to support the ongoing economic activities.

This nation cannot afford to continue to grant further tax advantages to the business community while sloughing off the responsibilities of national government to the states. As presently contemplated, urban enterprise zone legislation is a delusion and a diversion from the real problems facing our inner cities. We are convinced it is part of a broader, sugar-coated strategy aimed at the destruction of hard-won protective legislation for the workers and the poor of our nation, organized and unorganized, a weakening of organized labor and additional giveaways to the business community without requiring any reciprocity to the nation as a whole.

Mr. Chairman, the AFL-CIO has long argued for specific, targeted approaches to job creation, inner city revitalization and reindustrialization. This past February the Executive Council designed a far reaching and comprehensive economic alternative to the Reagan economic program. The AFL-CIO alternative offers the most effective way to deal with our blighted inner cities and the high levels of unemployment that pervade them. It addressed in detail how to set the nation on a path of economic recovery, full employment and balanced economic growth. And, adds up to a call for a 180 degree reversal of the economic policies of this administration. A copy of the February Council statement is attached and I ask that it be placed in the record.

AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

LANE KIRKLAND
PRESIDENT

815 SIXTEENTH STREET, N.W.
WASHINGTON, D.C. 20006

THOMAS R. DONAHUE
SECRETARY-TREASURER

LEGISLATIVE ALERT!

(202) 637-5075

April 20, 1982

(This letter sent to all members of the House and Senate)

Dear:

The AFL-CIO opposes the "Enterprise Zone Tax Act of 1982" -- H.R. 6009 and S. 2298 -- which would establish special "Enterprise" zones in which basic safeguards over business would be weakened and companies would receive special tax cuts on top of the enormous tax giveaways provided last year. The "Enterprise" zone proposal adds up to an array of tax reductions and other devices which directly or indirectly encourage a diminution of government revenues, programs, standards, and safeguards.

The proposal would not create additional jobs. At most, the result would be shifting unemployment from one area to another. Instead of bringing stability and economic growth, the proposal provides a powerful incentive for firms to shut-down and abandon their communities and relocate in these sub-standard enclaves. The bill gives encouragement to counter-productive competition by fly-by-night firms that are more interested in a fast buck and exploitation than in economic development and job creation.

Last February the AFL-CIO Executive Council renewed its opposition to this proposal: "The Congress should reject the Administration's call for 'Enterprise Zones' that would create new sub-classes of citizens and instead, strengthen programs that directly address the problems of unemployment and deteriorating neighborhoods." The AFL-CIO -- in its "Alternative To Reaganomics" -- instead urged a program that targets deserving industries and businesses and creates an infrastructure without undermining responsible businesses and eroding hard-pressed communities.

This legislation, unfortunately, would undermine the role and function of government in any area where a zone would be located. The proposal requires the local government and the State in which it is located to agree in writing upon a course of action to reduce existing requirements borne by employers or employees in the zone. For example, a "course of action" could include a reduction of tax rates or fees applying within a zone. Moreover, the "course of action" can be funded from the proceeds of any federal program -- thereby setting the stage for this proposal to be a substitute for existing federal programs originally designed to rebuild and revitalize cities. We note also that the duration of a zone can be for as long as 24 years.

The Administration has estimated that the array of tax reductions granted in these zones could cost the Treasury $3.6 billion by the end of FY '87. However, the staff of the Joint Committee on Taxation has estimated that the loss to the Treasury could total as much as $18 billion by FY '87.

"First, because of data limitations, the Treasury estimates do not take account of losses associated with investments in rental housing and other rental real estate, investments by public utilities, and the revenue loss associated with the capital gains provisions in the bill. Second, the actual mix of economic activities in the zone or attracted to the zone could be very payroll intensive and have a high ratio of investment to payroll, substantially increasing the cost of the tax incentives relative to what was assumed. Finally, the average size of zones when they are actually designated by the Secretary could be much larger than (average employment of) 10,000 (persons). If, for example, employment in designated zones were to average 50,000, fiscal year revenue losses would be $0.5 billion in 1983, $2.0 billion in 1984, $4.0 billion in 1985, $5.0 billion in 1986 and $6.5 billion in 1987."

An example of these costs is the fact that the proposal includes wage subsidies to private employers through the back door of payroll tax credits. In addition, businesses in a zone would be relieved from paying capital gains taxes and would also receive additional investment tax credits ranging from 3 to 10 percent on top of the 10 percent investment tax credit under present law.

In addition to tax cuts, the bill would give Federal agencies and regulatory bodies discretionary authority to relax regulations such as those governing exports, regulations affecting accounting treatment of loans and inventories, issuance of securities, as well as regulations affecting various energy performance, coal conversion and conservation regulations. It also encourages the creation of foreign trade zones despite the fact that such trade zones destroy United States jobs and undercut United States trade and tax laws.

Therefore, the AFL-CIO urges that you reject the "Enterprise Zone Tax Act of 1982."

Sincerely,

Ray Denison

Ray Denison, Director
DEPARTMENT OF LEGISLATION

Statement by the AFL-CIO Executive Council

on

An Alternative to Reaganomics

February 15, 1982
Bal Harbour, Fla.

The Reagan Administration economic policies, which caused the current recession, must be reversed. This recession has rapidly become the worst since the Great Depression.

The Republican Administration cannot blame anyone else for this recession. The recession was started in July 1981 with Reagan's job-destroying, tight-money, budget-slashing policies. These policies must be stopped. Anti-recession, job-creating programs must be started immediately.

The unfair and excessive tax giveaways of 1981 must be changed to achieve greater equity, pay for the anti-recession program and reduce the runaway Reagan deficits. And the President's second-round budget cuts must be blocked.

The Administration has saddled monetary policy with an unbalanced fiscal policy resulting from President Reagan's huge tax giveaways to the wealthy. This abdication of fiscal responsibility by the Administration places excessive strain on the monetary system and leads to continued high interest rates that further worsen the recession.

The catastrophic economic problems the Administration has created are made even worse by a cruel and regressive ideology which rewards the rich, forgets the jobless, punishes the minorities, ignores the poor and destroys protections for working people, the elderly and the needy.

The President's 1982 State of the Union Message and his Budget Message add up to a total disregard for human needs and for the economic and social costs of high unemployment and recession. Nothing in his proposals will help jobless workers or hasten economic recovery. The President's "new federalism" should not divert public attention from the Administration's blatant failure. The President would thrust basic national responsibilities upon the states, which have historically failed their responsibilities. He would undercut the Constitution and turn America back to the chaos of the Articles of Confederation.

In the year since the Reagan Administration has taken office, adult breadwinners and blacks and other minorities have suffered worse unemployment than anytime since the Great Depression of the 1930s.

Official statistics concede that some 9.3 million men and women are now without jobs. But the true dimensions of the economic crisis are worse than the unemployment statistics.

In addition, another 1.2 million discouraged workers have stopped looking for non-existent jobs. These "hidden unemployed" don't show up in the government's unemployment rate.

Another 5.4 million workers want full-time jobs but can find only part-time jobs. These men and women and their families are suffering from reduced workweeks and reduced income.

Today America has nearly 16 million men and women who are suffering serious job loss and income loss. The real unemployment rate is 12 percent.

During 1982, one out of every three people in the labor force, more than 30 million Americans, will suffer some unemployment.

President Reagan tells us to wait. The Reagan Administration accepts the recession as unavoidable and engages in wishful thinking that a trickle-down investment boom will develop by itself in this depressed economy, even though the government's own statistics show that the business community has no such plans.

But millions of Americans are suffering and cannot afford to wait. Americans need jobs to put food on the table, pay the mortgage or rent and live in dignity.

Instead of acting to counter the deepening economic decline, the Reagan Administration has cut unemployment insurance benefits, reduced employment and training programs, and welfare assistance at the same time it has destroyed more than one million jobs putting more people on the streets in search of help that's not there. One has to look back 50 years to see such a heartless official reaction to the hardship and suffering of millions of unemployed Americans.

The AFL-CIO calls upon the Congress to reverse these economic policies and set the nation on a path to full employment and balanced economic growth.

OPPOSE BUDGET CUTS

We urge the Congress to reject the newly proposed budget cuts of $41 billion which follow cuts of $33 billion last year. The serious impact of this new budget on workers and the poor is evident in a partial listing:

* Job training programs would be slashed even further from last year's cuts.
* Trade Adjustment Assistance would be practically eliminated.
* Railroad workers' retirement, unemployment and sickness insurance would be eliminated as a separate program.
* Medicare benefits for the elderly and severely disabled would be scaled back.
* Federal employment would be cut by 75,000 over the next two years.
* Federal pay increases would be capped at 5 percent, regardless of comparability with the private sector.
* Retirement benefit protections for federal workers would be lowered.
* Housing support for low- and middle-income families would be curtailed or eliminated.
* Maritime construction support (CDS and Title XI) would be eliminated and operating subsidies (ODS) phased out.

- Mass Transit aid would be cut.
- Railroad transportation funds (Amtrak) would be reduced.
- Educational help to the disadvantaged would be lowered.
- Vocational Education support would be trimmed.
- Student aid and student loans would be cut back even further than last year.
- Economic Development Aid to communities would be terminated.
- Sewer and water treatment support would be postponed.
- Energy programs would be curtailed.
- Energy assistance to low-income families would be cut.
- Child nutrition would suffer further cuts.
- Welfare and food stamp programs would be sharply curtailed.
- Medicaid for the poor would be further reduced.
- Day care, foster care, adoption and child welfare would receive less.

RAISE REVENUES

In order to provide the funds for national priorities and basic protections to workers and the poor, as well as to provide funds for new job programs, the AFL-CIO calls upon Congress to undo the worst aspects of last year's tax giveaways to corporations and the wealthy. We also propose the closing of some long-standing tax loopholes.

Specific changes in the 1981 tax law should:

- Cap the 1982 and 1983 individual tax cuts at $700 per family.
- Repeal the leasing of tax credits by corporations.
- Repeal the new loopholes in the oil windfall profits tax.
- Modify the widened estate and gift tax provisions
- Repeal the future indexing of tax rates.

In addition, Congress should correct these tax loopholes:

- Change the foreign tax credit to a tax deduction.
- Repeal the foreign tax deferral privileges.
- Repeal the tax deferrals of the Domestic International Sales Corporation (DISC).
- Repeal the immediate write-off of oil and gas drilling costs and the special depletion allowances.
- Reduce the Investment Tax Credit to its former levels.
- Apply the lower corporate income tax rates only to corporations with profits of less than $100,000.
- Phase out the special capital gains exclusions.
- Repeal the special capital gains at death exclusions.

Defense expenditures should be scrutinized carefully, and any increases found necessary should be financed by a separate and equitable surtax on corporations and individuals.

CREATE JOBS

The Congress needs to enact a number of programs to provide jobs, alleviate the suffering of the unemployed, and turn around the worsening recession:

- Invest in public infrastructure for the nation's deteriorating communities, including sewer, highway, bridge, mass transit, railroad, and other needed facilities.
- Invest in human capital through effective training of the unemployed and provide public employment opportunities for those who still cannot find work after lengthy searches.
- Encourage low- and moderate-income housing.
- Establish a Reconstruction Finance Corporation to rebuild the nation's industrial base by aiding sectors of the economy and of the country that need special

assistance through loans, grants or guarantees.

- Limit harmful imports that aggravate the impact of the recession and weaken key industries.
- Extend unemployment insurance benefits to protect the long-term jobless.

The Congress should reject the Administration's call for "Enterprise Zones" that would create new sub-classes of citizens and instead, strengthen programs that directly address the problems of unemployment and deteriorating neighborhoods.

The President and the Federal Reserve should exercise their authority to control credit and channel funds to productive purposes, including housing, and to restrict unproductive credit flows for corporate mergers, speculative excesses and foreign investment.

The undue reliance on tight monetary policy, huge budget cuts in social programs, and big tax cuts for the wealtny must be reversed. Tax policy must provide sufficient funds for the nation to fulfill its responsibilities to its citizens, and to provide appropriate balance to the Administration's one-sided monetary economic policy. Budget cuts cannot become an end in themselves -- but should be evaluated in terms of justice and need.

The AFL-CIO is convinced that this alternative economic program will put the nation on a path to achieve full employment, stable economic growth, fairness in sharing burdens and a society with compassion for those who have too little.

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AFL-CIO Fact Sheet

with

An Alternative to Reaganomics

The Alternative provides for: increase revenues from undoing the worst aspects of last year's tax giveaways, scrutinizing defense outlays and financing any required increases with a corporate and individual surtax, restoration of newly proposed budget cuts, and establishing new jobs programs. It points out ways to raise additional revenues by closing specific tax loopholes:

INCREASED REVENUES

Increased Revenues from Revisions of Tax Law

	Anticipated Revenues (in billions)
Cap the 1982 and 1983 individual tax cuts at $700 per family	$20
Repeal the leasing of tax credits by corporations	8
Repeal the new loopholes in the oil windfall profits tax	2
Modify the widened estate and gift tax provisions	1
Repeal the future indexing of tax rates	=
Total	$31 billion

Increased Revenues from Savings

Scrutinize defense outlays and finance any required increases with a corporate and individual surtax	
Current proposed defense budget increase	$33
Total	$33 billion
Total of Increased Revenue & Savings	**$64 billion**

NECESSARY OUTLAYS

New Jobs Programs

	Anticipated Expenditures (in billions)
Invest in public infrastructure for the nation's deteriorating communities, including sewer, highway, bridge, mass transit, railroad, and other needed facilities	$ 5
Invest in human capital through effective training of the unemployed and provide public employment opportunities for those who still cannot find work after lengthy searches	5
Encourage low- and moderate-income housing	5
Establish a Reconstruction Finance Corporation to rebuild the nation's industrial base by aiding sectors of the economy and of the country that need special assistance through loans, grants or guarantees	4
Limit harmful imports that aggravate the impact of the recession and weaken key industries	—
Extend unemployment insurance benefits to protect the long-term jobless	4
Total	$23 billion

Restore Budget Cuts

Restore Proposed Budget Cuts	41
Total	$41 billion

Total New Jobs & Restoring Budget Cuts **$64 billion**

ADDITIONAL REVENUES

Additional Revenue Raising Proposals Achieved by Closing Specific Tax Loopholes

	Anticipated Revenues (in billions)
Change the foreign tax credit to a tax deduction	$10
Repeal the foreign tax deferral privileges	1
Repeal the tax deferrals of the Domestic International Sales Corporation (DISC)	2
Repeal the immediate write-off of oil and gas drilling costs and the special depletion allowances	6
Reduce the Investment Tax Credit to its former levels	7
Apply the lower corporate income tax rates only to corporations with profits of less than $100,000	9
Phase out the special capital gains exclusions	6
Repeal the special capital gains at death exclusions	6
Total	$47 billion

Total Additional Revenues from Closing Loopholes **$47 billion**

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From Foreign Affairs, Spring 1982

Sol C. Chaikin

TRADE, INVESTMENT AND DEINDUSTRIALIZATION: MYTH AND REALITY

The American labor movement has basically concentrated on domestic issues—with the notable exception of its vigorous efforts to further the cause of human rights, free trade unionism and political democracy throughout the world. This focus on the United States has been the result of both the sheer size of the American economy and work force and the specific circumstances which gave rise to the rapid growth of the labor movement in the 1930s.

The renaissance of organized labor in this country during the depression years was based mainly in the manufacturing sector. In those days, international trade accounted for a minute part of the nation's total output of goods and services. It was, therefore, manifest that the problems of the national economy that culminated in the Great Depression resulted from deficiencies in domestic policy. Gradual economic revitalization in the New Deal years reinforced the views of labor leaders that the viability of the American economy was inextricably and almost exclusively linked with the domestic scene.

In the early 1960s, workers in a number of labor-intensive industries, particularly the apparel industry, began to experience economic distress. For some, the problem was outright loss of jobs; for the majority, earnings failed to keep pace with average manufacturing wages. That this could occur during what was to become the longest period of sustained economic growth in American history was cause for consternation. What was happening compelled those affected to look beyond our borders.

It rapidly became obvious that the dilemma was due to market dislocations in the wake of a growing tide of imports. Unions might have been expected to respond by calling for a cessation of

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Sol C. Chaikin has been President of the International Ladies' Garment Workers' Union since 1975. He is a Vice President of the AFL-CIO, and a member of its Executive Council and of its Trade and International Affairs Committees. He is also deputy member of the Executive Committee of the International Confederation of Free Trade Unions, and was a member of the U.S. delegation to the Belgrade and Madrid sessions of the Conference on Security and Cooperation in Europe.

all labor-intensive imports. The International Ladies' Garment Workers' Union, however, did not follow that path. Unlike most unions in the United States, the ILGWU was founded by immigrants who arrived in this country with a firm commitment to the international solidarity of working people. The ILGWU leadership needed no lessons in the importance of international economic cooperation to maintain world peace. It rejected and continues to oppose a philosophy of extreme protectionism.

The threat to American jobs and living standards that had been limited to a few industries has now multiplied to the point where it affects workers—and many employers—in almost every industry. The issue is no longer the viability of entrepreneurial manufacturing. The specter of deindustrialization is not only apparent, but has continued to grow at a geometric pace.

In the course of more than 40 years as an officer of the ILGWU, I have been closely connected with the industrial scene. Especially since becoming the union's president in 1975, I have often discussed the loss of American manufacturing with my corporate counterparts. I have heard the concern of other union leaders in the highest councils of the labor movement and that of workers on the shop floor, along with the thinking of my opposite numbers in the developed and developing nations. Insights have also been gained in exchanges with government leaders in the United States and abroad and through participation in negotiations affecting both bilateral and multilateral trade.

The experiences of the apparel industry in particular and of the nation's manufacturing base in general have compelled me to think through more thoroughly the current implications of postwar national economic policy. I would like to share these explorations and some of the resulting conclusions.

II

By the end of the Second World War, U.S. trade policy had shifted radically from the autarky of the 1930s to an ideology of "free trade." International cooperation created by the wartime alliance and the emergence of the United States as the dominant Western power were catalysts in this change. In the immediate postwar years, the output of the United States represented an unprecedented share of global industrial production. By 1948, three years after the end of the war, American output still represented more than half of the world's industrial product. America's newfound love affair with free trade was, consequently, solidly based upon a pragmatic assessment of domestic potential.

Prosecution of the war had brought important changes in the

American economy. Fabrication of war material and the growth of the armed forces had reduced depression-related unemployment to a point where the dream of a full employment economy seemed possible. Capital outlays, encouraged by military needs, and research and development, both of which were underwritten by the government, had helped to modernize industry, yielding impressive gains in output and productivity.

Military expenditures declined sharply with the end of the war and millions of discharged servicemen reentered the domestic work force. The likelihood of a postwar slump was advanced by most economists, who foresaw a severe downturn once pent-up demand for consumer goods, created during the war years, was satisfied. The most effective way to avoid that prospect was to ensure new outlets for American industrial capacity.

If only in purely economic terms, the postwar U.S. commitment to a greater degree of unrestricted trade made a great deal of sense. Given the destruction of industrial plant in much of Europe and Japan and the time period they needed to rebuild, extraordinary advantages of the United States in capacity, technology and productivity permitted the economy to prosper. While Europe and Japan were rebuilding their industrial bases, American manufacturers enjoyed an unchallenged share of world markets which helped to facilitate rapid conversion of the economy to peacetime production and avert an economic downturn.

Postwar trade policy also enhanced opportunities to attain strategic political goals. The United States sought through the Marshall Plan to assist in the reconstruction of devastated European economies as an integral part of an effort to create and strengthen stable democracies. The Marshall Plan contributed significantly to Europe's recovery as did investment by American corporations, encouraged by government policy.

While the U.S. economy initially benefited from this policy, there were mid- and long-term costs associated with these efforts. In time, financial assistance, investment, shared industrial knowhow and the rebirth of war-devastated economies began to diminish the advantage American manufacturing enjoyed in the period immediately following World War II.

As American investment in Europe continued to grow, the relative availability of capital for domestic investment declined. Earnings of European subsidiaries of U. S. corporations were not fully repatriated, further increasing the gap between potential and actual domestic capital formation. While overseas investments by U. S. corporations enhanced the profitability and competitiveness of these corporations, they restricted growth possibilities in the domestic economy.

The implicit restriction of domestic growth and the conscious sharing of the global market had aims which could not be calculated in purely economic terms. They were linked with efforts to avoid social unrest in Western Europe and to the establishment of a strong Western Alliance. The absence during the past 37 years of global military conflict, and especially of regional warfare in Europe, has been one outcome of U.S. policy. Its value is incalculable.

American policy toward postwar Japan had similar ramifications. Emergence of a stable, friendly and economically viable order in Japan was, as in Western Europe, a vital American concern. Japan, and Asia as a whole, however, did not readily offer as significant a market in the immediate postwar years as did Europe. Nonetheless, for similar strategic reasons the United States provided aid and shared technology. The Korean War contributed to the rebirth and growth of basic Japanese industry as Japan became an important supply base for American and U.N. forces. Further substantial gains to the Japanese economy took place later, during the Vietnam War. The United States also provided an additional critical inducement to Japanese industries by establishing and helping to maintain until 1971 a foreign exchange rate favorable to the Japanese, even as that country pursued a highly protectionist trade policy.

America's postwar export predominance could not continue indefinitely, especially after Germany, France and Japan re-created and further developed their industries with the most advanced available technology. Throughout the 1950s and into the early 1960s, aided by the absence of large-scale military expenditures, both Japan and the principal countries of Western Europe enlarged plant and equipment and increased consumer output, thereby creating near full-employment economies and raising living standards. As their industrial plants grew, these nations devoted greater attention to increasing exports. American multinationals captured a share of the domestic and export markets in Western Europe and, to a far lesser extent, in Japan. Initially, the domestic economy in the United States was not as severely affected as had been anticipated earlier. The unbroken domestic growth of the 1960s made the markets of Western Europe and Japan relatively less important.

III

As a result of U. S. government policies and private encouragement, as well as the need to pay for raw material imports used in its growing industrial machine, Japan increasingly pursued a model of export-oriented development in a number of key industries. In this, of course, Japan was not alone. If Japan were an isolated case, perhaps trade policy would not bear so heavily on our current economic problems. But Japan is not an isolated case. Rather than acknowledging that there are limits to the American economy's ability to absorb imported goods, U. S. policy has been one of encouraging developed and developing nations to increase their exports to this country.

Continuation of a policy of relatively unrestricted trade without incurring disastrous internal results must be viewed both in the context of the domestic economic circumstance and, because the actions of the United States have international implications, in terms of foreign policy goals.

The consequences of this policy for domestic manufacturing have changed and intensified in the course of the last two decades. Yet, despite the growing importance of the problem, discussion of import-penetrated industries was, as recently as ten years ago, extremely narrow in scope and short in duration. The sectors concerned—primarily labor-intensive industries—were few, and, to most observers, imports did not appear to be a general threat to U.S. manufactures. Industries experiencing difficulty competing with foreign goods were viewed merely as isolated cases.

In the 1970s the nation came to learn that excessive import penetration was not peculiar to such labor-intensive industries as apparel, textiles or home electronics. The experience in these sectors was merely a preview of similar dislocations which have now affected almost every facet of American manufacturing.

Many nostrums have been suggested over the last 20 years. When the members of the ILGWU were first confronted with the rising tide of apparel imports from developing countries, we were advised that the solution in our labor-intensive industry was simple. Domestic industry, it was said, should become more competitive by improving worker productivity.

Even in the less-developed countries, however, apparel is manufactured with essentially the same state-of-the-art technology employed in the advanced nations. Frequently, manufacture abroad has been implanted by American corporations. Designs and production techniques created in the United States and supported by

American merchandising skills are used in the developing countries. Capital, technology and managerial know-how have been internationalized, leaving no opportunity for domestic apparel manufacturers to obtain a meaningful edge in productivity. Consequently, wages represent the only area in which the domestic industry can compete in an open market with imports from the developing world.

By the standards of other manufacturing in the United States, wages in the domestic apparel industry are not high. Across the country, a sewing machine operator earns an average of $5.00 to $5.50 per hour. With benefits, this comes to total compensation of roughly $6.75 per hour. But workers in the major exporting countries earn a small fraction of this amount—less than $1.00 per hour in Hong Kong, less than 40 cents per hour in Taiwan, Korea or Singapore, about 20 cents per hour in India and even less in Sri Lanka and the People's Republic of China. For garment workers in the United States to compete with such wage levels, even taking into account shipping costs and applicable tariffs, would mean that they would have to accept total compensation of hardly more than $1.00 per hour.

When we brought this to the attention of the policymakers, they responded that additional constraints on apparel imports were still unwarranted. If the domestic apparel industry could not compete on a global basis, so be it. The displaced workers, they contended, would find other work in such industries as shoe production, novelties or plastics, where the skills were highly compatible. Yet these labor-intensive industries were afflicted with the same malady—they too were losing jobs in the wake of growing imports from low-wage areas.

Policymakers and corporate spokesmen then suggested that the loss of labor-intensive manufacturing jobs should not be cause for alarm. People displaced by imports, they maintained, could be retrained for better jobs in capital-intensive industries—autos, steel or, better yet, the technology-intensive growth industries. Such a stratagem, however, had first to cope with limitations on upward or even horizontal job mobility.

IV

Even under the best of economic circumstances, occupational adaptability is far from perfect. As the shortcomings of the War on Poverty of the late 1960s clearly demonstrated, the American labor force has a broad spectrum of skills. High levels of employment and minimal unemployment, therefore, require a full spectrum of job opportunities—from the least skilled to the most advanced. Fitting people into job slots is a complex and frequently disheartening exercise, especially when an industry or a substantial fraction of it is phased out of existence. Limitations on occupational adaptability, which some economists slough off as "structural unemployment" (as though there are no human bodies behind that bland concept), are compounded by constraints on mobility created by family ties, inadequate financial resources, educational limitations, lack of access to information regarding available jobs, or de facto sex or racial discrimination.

In periods of economic stagnation or retrogression, it is difficult, if not impossible, to upgrade workers whose skills have become technologically or economically obsolete. Particular attention must, therefore, be paid to the availability of jobs in industries where skills are roughly compatible. Otherwise, massive sectoral unemployment results. Trends in several key industries thus have a critical bearing upon trade policies and, more broadly, upon industrial development and growth.

Between 1965 and 1981, the import share of developed countries in the domestic U.S. auto market grew from six percent to over 27 percent. Foreign-made trucks accounted in 1973 for only five percent of domestic purchases; in 1981, the figure had risen to 20 percent. The pattern in steel, the nation's backbone, parallels the auto industry's experience. From barely five percent in 1962, the import share of the developed countries in the domestic steel market increased nearly fivefold to almost 25 percent in 1981.

It is currently being said that the decline in the market share of domestic auto and steel output, as in many labor-intensive manufacturing industries, may well be an affordable price to pay for a productive restructuring of the American economy. This argument suggests that basic manufacturing is a drain on the resources available to technology-intensive industries. The latter, it is contended, should be the mainstay of an economically advanced nation. The proponents of this view concede that it will result in some permanent unemployment, but, they argue, the long-run result will be a more competitive economy. The problem presented by occupational adaptability is acknowledged, but subordinated to the conclusion that promotion of high-technology industries will ultimately produce the most effective means to secure real economic growth. Such growth, it is said, would in time provide for considerably lower levels of unemployment.

Even if the enormous problem of occupational adaptability is ignored, dependence upon technology-intensive industries as the primary source of manufacturing employment is conceptually flawed. It fails to take account of the small labor component in technology-intensive production, compared with either labor-intensive or even most capital-intensive manufacturing.

Thus, under the most ideal of circumstances, reliance on technology-intensive production could not support present levels of manufacturing employment, let alone reduce current high unemployment. The practical deficiencies of this development concept are underscored, moreover, by evidence that the market shares for domestically produced technology-intensive goods are themselves declining.

A case in point is the American electronics industry, a field that truly grew out of American ingenuity. The basic new discoveries in the industry were made in this country over past decades, with defense and space programs providing enormous resources for research and development and guaranteeing a market for innovation. America's infrastructure has been second to none, and our ability to provide industry with the best trained minds has been unparalleled. As recently as 15 years ago, the global preeminence of the United States in electronics surpassed achievements in any other industry. Yet what should have been an enormous advantage has now dissolved.

The erosion began in consumer electronics. From negligible import penetration 20 years ago, we have moved to the opposite extreme. By 1978, the import share for videotape players and household radios was 100 percent. There was *no* domestic production in these products. In the same year, imports accounted for 90 percent of all domestic purchases of citizens band radios, 85 percent of all black and white television sets, 68 percent of all electronic watches and 64 percent of all stereo components. Even such sophisticated consumer electronics as color television sets and microwave ovens had large import shares. The figures (respectively 18 percent and 25 percent for 1978), however, do not tell the entire story; they understate the actual significance of import penetration because products assembled domestically and counted as American production include substantial overseas value-added in the form of foreign-produced components, sub-assemblies, circuit boards and complete chassis.

If the evaporation of American manufacturing leadership were limited solely to consumer electronics, perhaps we could console ourselves with the preeminence we have maintained in the most sophisticated areas of research. Even here, however, the outlook is increasingly distressing. Semiconductors, for example, represent literally the most home-grown U.S. industry, and epitomize the cutting edge of America's technological strength. Yet from a starting point of zero import penetration in 1975, Japanese firms alone have captured 40 percent of the U.S. semiconductor market and are rapidly moving into the international arena. Nor are the Japanese content merely to produce what has been created in this country. In less than a decade, they have made impressive progress in areas of high-technology research that were once the exclusive domain of American enterprise. The United States no longer holds the lead in such exotic processes as electron-beam lithography or memory circuit design. Rather, this country must now struggle to maintain parity in these and many other areas of high technology.

Even the computer, that great American technological achievement, is not safe from the mounting pressure of foreign competition. *U.S. Industrial Competitiveness*, a July 1981 publication of the Federal Office of Technology Assessment, concluded that, ". . . the Japanese have managed great strides since 1970. . . . Japanese hardware now seems largely competitive with American. . . . While . . . Japanese computer firms have yet to establish any real presence in the U.S. market, they clearly intend to try."

V

The demonstrated ability of foreign competitors to rapidly displace key American manufacturers in both the domestic and international markets suggests a fundamental weakening of the American economy. Lagging productivity is often cited as a cause. Yet, while the *rate* of productivity growth in the United States has been relatively low throughout the 1970s, the *absolute level* of American manufacturing productivity remains the highest in the world and the differential is substantial compared with that of our major trading partners. In absolute terms, Japanese and West German productivity levels in 1980 were respectively 66.3 percent and 88.3 percent of the American figure.[1]

Lagging productivity growth—from 1973 to 1980 it rose at an annual rate of only 1.7 percent—is itself symptomatic of a more profound malaise. Like any symptom, it raises a number of ancillary questions. Why has the American economy (not unlike that of Great Britain) increasingly failed to replace many of its worn-out, antiquated, uncompetitive factories? Why has plant capacity utilization been so low during most of the 1970s that it currently rests at one of the lowest levels since the Great Depression? Why have major American corporations been drawn increasingly toward acquisition of other large companies and toward continued high levels of foreign investment?

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[1] These estimates are those of the Bureau of Labor Statistics. The BLS data were cited before a congressional subcommittee by Under Secretary of Labor Malcolm R. Lovell, Jr., who noted that: "International comparisons of productivity are very difficult to make. The best available data [by the BLS] show that the United States has a higher output per employed person than other major developed countries, but that the gap is being narrowed." Statement of Mr. Lovell before the Subcommittee on Trade of the House Committee on Ways and Means, October 21, 1981, xeroxed statement, p. 10. The relevant BLS table is unpublished but available on request under the title, "Real Gross Domestic Product . . . per Capita and . . . per Employed Person, 1950-1980." The figures presented by Mr. Lovell have since been slightly revised, to those given above.

Broadly speaking, this country has been following policies which can only lead to intensified deindustrialization. Unrestricted import penetration (during more than a decade of economic stagnation and retrogression) and insufficient new investments have played a vital contributing role in this process.

To the extent that imports have captured significant shares of the American market, demand for domestically manufactured goods has declined and there has been a substantial drop in domestic output. The resulting excess of capacity requires fixed overhead to be amortized on the basis of fewer units of production. The consequently high capital consumption costs per unit represent an inflationary pressure which results in higher prices and lower profit margins. The former diminish the competitiveness of U.S.-based industry, and the latter decrease the attractiveness of new productive investment.

Another inflationary pressure which accompanies unused capacity is reduced labor productivity. Managerial and professional staff cannot always be reduced in proportion to cuts in output. The same is often true of technical, maintenance or clerical staff who must perform essential functions irrespective of the level of output. Increased unitized labor costs which accompany excess capacity place an added burden on import-penetrated industries. Additionally, layoffs of key managerial and professional personnel, now taking place at an increasing rate, lead to sizable losses in investment, both in skills and in special knowledge of the firm and industry.

The negative effects of high levels of unused capacity in key industries have become even more self-perpetuating for two reasons. First, in relatively short order, supplier industries are affected as demand for industrial commodities decreases substantially. The high and persistent unemployment caused by diminished output has a snowball effect, reducing consumption and restricting growth in nearly every economic sector. Second, excess capacity affects management investment decisions. In competitive, entrepreneurial industries such as, for example, apparel and consumer electronics, the general response to imports has been to shift further from manufacture to importation and distribution. Although the strategies vary among specific corporations, the major corporations in this country have dealt with unused capacity by increasing overseas investments, by mergers and acquisitions, or by speculation in currency, commodities and various financial instruments.

Finally, there is a propensity on the part of consumers who have altered their purchasing patterns in favor of imports to maintain that pattern. Irrespective of any future efforts by American producers to regain the market, a sizable residual level of demand for imports will remain.

VI

From 1950 to 1980, direct foreign investment by American companies expanded from $11.8 billion to $213 billion, an average annual growth rate in excess of ten percent. The comparable average for domestic investment in the same years was less than seven percent. This latter figure, however, is deceptively high, since in recent years massive amounts of money counted as productive investment have actually been used to finance corporate mergers and acquisitions.

Direct foreign investments divert assets which could stimulate domestic growth, improve productivity and increase American competitiveness in world markets. Tens of billions of dollars have been used to substitute foreign jobs for jobs in the United States. Mergers and acquisitions, which have dominated domestic corporate finance in recent years, have neither spurred growth nor created jobs. Resultant concentration of ownership, however, has contributed to the furtherance of oligopoly and with it increased levels of inflation.

The rationale behind U.S. Steel's acquisition of Marathon Oil is a case in point. At a time when the American share of both domestic and world steel output is shrinking and when mass layoffs have crippled entire communities, expending $6.4 billion to purchase a thriving energy company would not appear to be the best way to serve the interests of the nation. The motivating logic was, perhaps, best expressed by Thomas Graham, Chairman of Jones & Laughlin Steel Corporation, who, in a November 23, 1981 interview with *The New York Times*, stated: "There's too much capacity in the free world. We in the U.S. have been victimized by imports for 20 years. It would be an imprudent businessman who would expand until those problems are solved."

What he describes is part of a vicious cycle. Low levels of real domestic investment in past decades and excessive import penetration deprive American manufacturers of the incentive to expand. Plants become obsolete, further eroding competitiveness. Firms that lack resources die or are swallowed up. Those that have resources produce an increasing share of their output overseas, adding directly to domestic unemployment, diverting capital from domestic investment and making the United States even less competitive. Others engage in acquisitions which neither increase output nor cut costs. Those with adequate resources have engaged in speculation in the dollar, earning huge profits at the expense of price levels. Investment in financial instruments in lieu of productive outlays is yet another variation of the domestic deindustrialization process.

On January 29, 1982, *The Wall Street Journal* reported that, rather than expand its high-technology base, Bendix Corporation "may be content to keep its $500-million pool of cash in short-term investments." Citing a rate of return for its investment portfolio more than double that of its manufacturing equity, Bendix Chairman William M. Agee concluded: "We may be an investor of money for an extended period of time."

These alternative processes have renewed and intensified the cycle of deindustralization; they are largely responsible for the loss of more than half of all the jobs in consumer electronics and large segments of steel, auto, home appliances, shoe production, tire and rubber output and apparel. There is no reason to believe that the trend will not continue to develop in every aspect of manufacture, simply because neither business nor government appears willing to do anything about it.

Since Japan has become the highly touted model of what to do, it is of interest that the Japanese have avoided this circular dilemma. As reported in *The Journal of Commerce* of November 6, 1981, Dr. Edwards Deming, often referred to as the prime architect of Japan's postwar boom, has observed:

> Management has failed in this country. The emphasis is on the quarterly dividend and the quick bucks, while the emphasis in Japan is to plan decades ahead. The next quarterly dividend is not as important as the existence of the company 5, 10 or 20 years from now. One requirement for innovation is faith that there will be a future.

Dr. Deming's last point should be emphasized in view of the apparent conclusion in some quarters that American manufacturing is expendable. Some of our economic pundits even suggest that industrialized countries, particularly the United States, abandon manufacturing and concentrate on service industries.

VII

The notion of an economy based entirely on services raises several distinct problems. Elimination of manufacturing jobs removes the usefulness of skills for which there is no analogue in the service sector, and creates insurmountable problems with respect to occupational adaptability. Loss of investment in the training of literally millions of industrial workers represents an additional massive cost to the economy. Because there are relatively few well-paying jobs in the service sector, an economy devoid of manufacturing would also necessarily experience a general decline in living standards.

Aside from the direct economic effects, a pure service economy in the United States would diminish and ultimately eliminate the nation's capacity to provide the technological edge upon which American defense strategy rests. The viability of defense industry is inextricably linked with the highly diversified nature of American manufacturing. Equally essential is the ability to produce components to maintain and operate the defense apparatus. Forfeiture of America's industrial base would, in time, reduce the United States to the status of a client nation with respect to the purchase of arms.

Additionally, an economy which forfeits its right to produce for its own needs would also be unable to encourage general technological skill or innovation. Forfeiture of this country's goods-producing sector would compel the best technological minds to migrate.

Unrestricted trade and the investment practices of the multinationals, as I have contended throughout this article, can only lead to an America ultimately devoid of manufacturing. Nevertheless, present trade and investment policies must also be viewed in a broader context than just the domestic economy. The United States has responsibilities and strategic interests that must also be considered. They relate as well to nations seeking economic development.

VIII

Developing countries have been encouraged to adopt a rapid industrial development model, one that is heavily dependent upon export-oriented manufacture. However, the proposition that rapid industrialization of developing countries via exports contributes to the establishment of stable democracies is highly questionable. American trade policy toward Japan, for example, was only one component in a comprehensive plan that included genuine fostering of human rights and the establishment of institutions necessary to the existence of a participative democracy, including the creation of a national labor movement. The absence of similar efforts in the developing nations has severely limited the liberalizing role of trade. This is particularly clear with respect to those nations' chief resource—cheap labor.

In a world in which capital, technology, managerial skills and transportation techniques are largely internationalized, labor costs take on a special importance. Often labor represents the only meaningful variable in production costs. Consequently, rising wages make national economies that are dependent upon export income vulnerable to competition from other developing nations. This vulnerability is exacerbated by the difficulties associated with transition from export-oriented rapid development to an integrated industrial economy.

In those nations that have been characterized as new industrial countries, the policy has been to maintain artificially low wage rates and to permit unconscionable employment practices. These practices have resulted in economic polarization and repression of workers' rights—outcomes which perpetuate autocratic rule.

In short, unrestricted trade and investment do not benefit the majority of American workers or employers who depend upon the domestic market, nor do they benefit the majority of people in the developing nations. They serve neither American strategic nor political interests. Who, then, benefits from present policy?

The multinational corporations have the best of both worlds in developing nations. Their massive resources place them in an enviable position to negotiate with a prospective host country, enabling them to exact favorable conditions. Tax abatements, donations of land, site preparation, and waiver of requirements that they comply with government regulations are among the standard concessions made to global firms. Less publicized is the de facto subsidization of profits which occurs when the host country takes measures to keep wages artificially low. The incentive for repressive measures in developing countries comes, additionally, from the certain knowledge that there are other developing nations eager to host multinationals, nations where living standards are even lower.

How then should the United States deal equitably with assistance to developing nations, and, at the same time, maintain existing jobs, create additional employment, arrest the declining role of American industry and rebuild its industrial base?

IX

There are a number of specific measures that would facilitate reindustrialization in the United States and lead to positive development for both the United States and its trading partners. Implementation of a rational system of fair trade should certainly be a priority. Central to such a trade policy would be import quotas negotiated on a global basis in those sectors where import penetration has significantly diminished domestic employment and threatens to continue this process.

Increments in imports should be linked to the ability of the American economy to absorb them. Massive disruptions in domestic markets, the result of large increases in import levels from exporting countries, should be avoided. Negotiated import quotas would permit exporting nations to know in advance the potential size of the market in the United States and their share in it, and permit them to plan accordingly. Moreover, allocation on a global basis would prevent the rapid shift of market shares to nations where living standards are even lower than in the traditional exporting nations. A rational policy of fair trade can protect job opportunities in exporting as well as importing nations.

Let me emphasize that I am in no way advocating a revival of autarky. A return to the protectionism that characterized American trade policy in the 1920s and 1930s would be disastrous. I am just as convinced, however, that if we continue our present policy, mounting political pressure will make total protectionism unavoidable. Little time is available to begin corrective measures. The evident trend toward autarky is not likely to abate in the wake of anticipated levels of unemployment in excess of ten percent and the fear of continued high levels of unemployment, even with economic recovery.

Profit-seeking, regardless of its costs to our nation and people, has been central to the process of deindustrialization. The rate of return on U.S. direct investments abroad is, as I have observed, significantly higher than profits on domestic investments. Many of the largest corporations and banks make 50 percent or more of their profits abroad, providing an irresistible incentive to those with enough resources to operate on a global basis. The allure also holds for diversification, via mergers and acquisitions.

This is not an indictment of the business community. I am saying, however, that in the interest of short-term profits America may be losing sight of its priorities. Most critical among such priorities is an acceptance of the principle that full employment, a viable goods-producing sector and decent living standards are essential to the national interest and to the interests of those nations that depend upon the strength of our economy.

A rational policy of fair trade is only a starting point. A common ground among labor, industry and government in pursuit of full employment must be found. To those who counsel that such a goal would be excessively costly, I say simply that the costs are miniscule compared with the price of high unemployment. Economic chaos caused by the Reagan Administration's shortsighted policies now threatens to result in the highest federal deficits in American peacetime history. This cost is a mere shadow of the penalty that unemployment places on the national economy, in terms of foregone income and missed improvements in the quality of American life.

To compete in both the domestic and world markets, this nation must increase productivity, not lower the American living standard. A meaningful commitment to full employment will increase demand, allow idle plant to be more fully utilized and result in new productive investment and important increments in productivity. In such an environment, fears of technological or import-related displacement would be largely mitigated and technological innovation permitted to proceed at an unprecedented rate, to the benefit of Americans as well as the people of other countries.

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Senator CHAFEE. Now, do I understand Mr. Panichi showed up? I'll tell you what—I have another appointment—why don't you step up and tell us a little bit about what you are interested in in 3 minutes? We put your statement into the record, but why don't you summarize it?

Mr. PANICHI. I apologize for being late. I was told that it was going to be a little later, and it's my error.

Senator CHAFEE. All right.

STATEMENT OF VINCENT PANICHI, CIUNI & PANICHI, CLEVELAND, OHIO, FOR THE COUNCIL OF SMALLER ENTERPRISES, CLEVELAND, OHIO

Mr. PANICHI. Thank you for asking us here to testify today.

I am here with John Polk, who is our director of the Council of Smaller Enterprises, and Jim Trutko, who is our director of research for the Greater Cleveland Growth Association.

We are testifying on behalf of the Council of Smaller Enterprises, a division of the Greater Cleveland Growth Association and Small Business United, a coalition of small business groups. We also represent Cleveland's interest in the enterprise zone concept, and we want to acknowledge the continued interest of the city of Cleveland in this legislation.

Over the past 10 years, the Council of Smaller Enterprises [COSE] has developed into the largest local small business organization in the United States. COSE's 4,000 members employ more than 100,000 people throughout Greater Cleveland. Small Business United is a coalition of regional——

Senator CHAFEE. I'll tell you what. We've got your statement. Why don't you just give us your views on this legislation.

[The prepared statement follows:]

TESTIMONY OF VINCENT M. PANICHI ON BEHALF OF THE COUNCIL OF SMALLER ENTERPRISES

Thank you for asking us here to testify today.

We're testifying on behalf of the Council of Smaller Enterprises, a division of the Greater Cleveland Growth Association and Small Business United, a coalition of small business groups. We also represent Cleveland's interest in the Enterprise Zone concept and we want to acknowledge the continued interest of the City of Cleveland in this legislation.

For more than a decade, the Greater Cleveland Growth Association has successfully promoted entrepreneurship by bringing the combined volunteer resources of Cleveland's business community to focus on the issue of small business development. Within the Growth Association many developmental services are currently available to smaller ventures both through the Council of Small Enterprises and through the Cleveland Area Development Corporation.

Over the past ten years, the Council of Smaller Enterprises (COSE) has developed into the largest, local small business organization in the United States; COSE's 4,000 members employ more than 100,000 people throughout Greater Cleveland. COSE's success in the development of programs and services to support entrepreneurship through the efforts of a commited core of volunteers has won the organization nationwide recognition.

Small Business United was organized in 1981 to formalize a group of small business organizations with a dedicated interest in national governmental issues. SBU is a coalition of regional, state and metropolitan small business associations representing 37 states across the country. SBU's uniqueness lies in its utilization of the entrepreneur as a "grassroots constituent lobbyist" to provide national decision makers with a "real world" perspective of the economic needs of the small business community. Each year, SBU's Washington Presentation attracts several hundred small business representatives to the Capitol to present the group's legislative agenda to Congress.

THE ISSUES

Briefly, as we understand the concept, the "Enterprise Zone" (E.Z.) concept generally focuses on reducing "supply side" barriers to the formation and continued viability of businesses in depressed areas. The economically depressed areas that most people seem to have in mind are usually large neighborhood size regions within central cities, although many people use the E.Z. concept very loosely to refer to many different geographical areas. The approach usually involves government undertaking tax and regulatory reform in order to reduce the cost and restrictions of operating a business in the Enterprise Zone. Other general incentives may also be added to the package, including focusing existing grants and incentives on the E.Z.

The ultimate rationale for governmental action lies in the deterioration and disinvestment processes of the central cities. In the E.Z. legislation, the government is attempting to deal with two social problems (loss of employment in the central city and deterioration of the tax base) indirectly through business locational incentives.

Small business is clearly an important element of any economic redevelopment strategy. Both retention and expansion of existing business and the formation of new enterprises must be concerns of public policy. In the City of Cleveland, we have approximately 15,500 business establishments employing over 350,000 workers, which is about 40% of the entire metropolitan workforce. About 97% of these or 15,000 firms employ less than 100 employees, or 40% of total employment today. In terms of jobs for Cleveland in the future, we know from national statistics that two-thirds of the new jobs will come from small business - those with 20 or fewer employees.

As we see it, you would like us to address at least 3 major issues:

DESIRABILITY	1)	Do we favor the E.Z. concept in general as an urban policy approach?
EFFECTIVENESS	2)	What is the likely impact of the proposed E.Z. legislation on small business?
MODIFICATIONS	3)	What modifications can we suggest to improve the legislation?

DESIRABILITY

On the first question, that of the desirability of E.Z., we are in favor of the concept of attempting to harness private sector investment decisions in order to help maintain the tax base and boost employment through supply-side incentives such as tax and regulatory action. The targeting of special tax incentives on the central city is proper because in most cities, the central city's business climate affects the entire region.

But, at the same time, we have some reservations about whether the incentives proposed are sufficient to spark investment. From our own research and experience, it is apparent that the order of magnitude of disinvestment from the city is significant and substantial incentives will be needed to change this trend. This suggests that a broad range of incentives must be included if the legislation is to be effective. This also suggests that we recognize that enterprise zones alone are only a partial approach to urban deterioration. We want to caution against having unrealistic expectations about the extent of enterprise zones' limited (but beneficial) impact.

EFFECTIVENESS

A second question that we want to address is that of effectiveness - what is the likely impact of the proposed E.Z.? As we see it, the effectiveness will depend on several factors:

1) Development of an effective partnership between the federal, state and local governments representing the public sector, and the private sector.
2) Adoption of a realistic longer-term time horizon in which you expect to see results.
3) Providing adequate incentives and dealing effectively with the major barriers limiting business development in declining areas.

The first key to making sure E.Z. are effective is to forge an effective governmental and public-private partnership. We must look at relationships of shared responsibility for revitalization between the federal and local governments representing the public sector, and industry and commerce representing the private sector. We think that local initiative in revitalization is absolutely essential, but we must recognize that we are working in a national context as well - a national economy with national tax and regulatory policies and national capital markets. The problems we face have some broad structural characteristics which are long-term in nature and difficult to attack with only local resources.

In concrete terms, this means that one of the keys to redevelopment is ensuring that all levels of governments have a consistent and integrated set of objectives working in the same direction. The fragmentation and inconsistency of redevelopment efforts among the different levels of government has simply not led to meaningful redevelopment on a broad scale. The competitive element of the E.Z. gives the different levels of government a good incentive to work out their differences and to establish a coherent development process. Thus we support the concept of awarding E.Z. on a competitive basis, rather than on an entitlement basis. The overall cost issue should be addressed through limiting the number of cities awarded E.Z. status, rather than through reducing the size and scope of incentives.

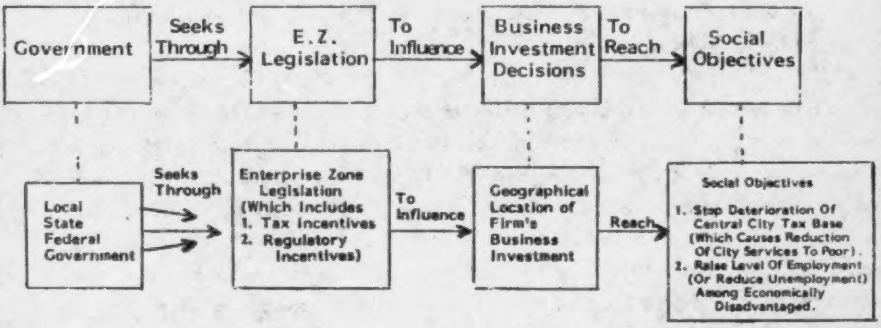
In our view, one of the most desirable features of the E.Z. concept is the degree to which it emphasizes strong local participation from both the public and private sectors. A strong local role is clearly one aspect favored by our membership. A few years ago we did a survey of over 1,000 companies in Greater Cleveland to determine the level of government that business thought could best assist them. We found that over half (51%) of the companies thought that the cities could better assist them, compared to 37% for the federal government, 34% for the state and 31% for the county.

In addition, we applaud the recognition that private-sector initiatives are crucial elements of the long-term redevelopment process. A key idea in Cleveland's turn around in the last two years has been the public-private partnership. This partnership was recognized in the designation of Cleveland as one of the nation's All-American cities this year. Government can set a framework for action, but the revitalization process depends on the willingness and ability of private investors to stimulate economic growth. We think that it must be emphasized that the eventual goal of the E.Z. must be restoration of a normal development process between private sector investors - one in which direct government investment does not play a dominant role.

A second major element which will lead to effective E.Z. is patience. Government leaders must recognize that E.Z. represent an attempt by government to reach certain social objectives indirectly through the investment of private profit-oriented firms. As shown below in Figure 1, the business investment decision is the key variable to effect through E.Z. legislation for a simple reason; without the actual business decision being influenced, nothing will happen and no social objectives will be reached.

Because E.Z. work through investment decisions, the benefits will only come gradually as individual firms decide to make an investment decision. While E.Z. have a longer gestation period than many programs, they will eventually generate solid, meaningful private sector jobs with a future.

FIGURE 1


Government
Seeks Through
E.Z. Legislation
To Influence
Business Investment Decisions
To Reach
Social Objectives
Local
State
Federal
Government
Seeks Through
Enterprise Zone Legislation (Which Includes 1. Tax Incentives 2. Regulatory Incentives)
To Influence
Geographical Location of Firm's Business Investment
Reach
Social Objectives
1. Stop Deterioration Of Central City Tax Base (Which Causes Reduction Of City Services To Poor).
2. Raise Level Of Employment (Or Reduce Unemployment) Among Economically Disadvantaged.

A third element of making E.Z. effective is more complex: it involves providing adequate incentives and dealing effectively with the major barriers limiting business development in declining areas.

Where are we today with the areas that we see as tomorrow's E.Z.? How well do they stack up as business locations? The unfortunate truth is that the proposed E.Z., as they are today without E.Z. legislation, are generally not cost or revenue competitive with other areas in the metropolitan region. They are hard places for business to make a profit in and it will take well designed E.Z. with significant incentives to help turn them around.

To design a workable E.Z. concept, we feel that a total approach must address some of the specific barriers that face businessmen in declining areas, especially small businessmen. We did a survey a few year ago on some of the problems that we felt affected business expansion in Cleveland with over 1,000 companies, many of whom were small business. We found that over 60% of city businesses mentioned crime and neighborhood deterioration as problems; in comparison less than 30% mentiond them as problems in suburban areas. The next most common groups of problems involved motor vehicle transportation - parking, auto and truck congestion. Again, they were more common in the city than in the suburbs. (Table 1). In another section of the same survey, we found that more than one third of the respondents (37%) did not have adequate land/building for expansion at their current site. (Table 2). Surprisingly, we found that only about one-sixth of the respondents found the city's building codes detrimental to their expansion. (Table 3).

TABLE 1

DO YOU FEEL THAT IN YOUR AREA (   ) IS A PROBLEM?

	COMPANY LOCATION			
PROBLEM	CLEVELAND EAST	CLEVELAND WEST	SUBURBS EAST	SUBURBS WEST
CRIME	73%	72%	32%	26%
NEIGHBORHOOD DETERIORATION	61%	58%	29%	10%
PARKING	56%	52%	23%	27%
AUTO CONGESTION	42%	55%	32%	43%
ATTITUDES OF RESIDENTS TOWARDS BUSINESS	31%	30%	21%	21%
TRUCK CONGESTION	26%	45%	19%	21%

TABLE 2

DO YOU HAVE ADEQUATE LAND/BUILDING AVAILABLE AT YOUR CURRENT LOCATION FOR EXPANSION

ROOM FOR EXPANSION	% OF SAMPLE
YES	57%
NO	37%
NO ANSWER	6%
TOTAL	100%
(BASE)	(1003)

TABLE 3

HAVE YOU FOUND YOUR CITY'S BUILDING CODES DETRIMENTAL TO YOUR EXPANSION?

CODES DETRIMENTAL	% OF SAMPLE
YES	16%
NO	71%
NO ANSWER	13%
TOTAL	100%
(BASE)	(1003)

PREPARED BY: THE REGIONAL ECONOMIC DEVELOPMENT DIVISION
GREATER CLEVELAND GROWTH ASSOCIATION
JANUARY, 1979

Small businesses face two additional problems in attempting to operate in economically declining areas. The first is that a small businessman's capacity to deal with local problems is severely limited. Whereas large businesses can often modify to some extent the areas surrounding their facilities, small business do not have the scale or resources needed to modify their immediate locations by themselves and cooperative action is difficult, time-consuming and costly. Security forces, for example, are rarely a realistic possibility to deal with the problem of crime for most small businesses.

The second problem of small business is that they are particularly sensitive to the "image" problems of operating in a poor neighborhood because their small size often generates questions about their credibility and reliability. Small businessmen fear that many potential customers will not be comfortable about their locations. They also face pressure from important suppliers, banks, insurance companies and others who perceive a risky business environment.

Thus all of these factors - crime, transportation, land, small business resource and image problems - must all be considered in order to get a workable concept. In order to overcome some of these reservations we believe that you must establish linkages with other programs (such as UDAG's and CDBG's, for example) and provide fairly sizeable incentives. We will get into some specific suggestions for incentives in the next section, but let us reiterate our confidence that, despite these challenges, a viable E.Z. concept can be fashioned which will induce small business to locate in E.Z.

MODIFICATIONS

Finally, let us move to the last topic that you have asked us to consider - that of how to improve the E.Z. legislation. First, two general comments. In the eligibility area, we feel that the criteria for designation should more clearly emphasize urban and economic criteria (such as actual job loss within designated city and existence of underutilized or vacant buildings), rather than broad social criteria. We feel that this would focus the enterprise zone more clearly on specific economic problems rather than generalized conditions of social distress which cannot be addressed through E.Z.

Second, we feel that the legislation needs to strengthen its focus on small business incentives. This will probably help to keep costs down, mean higher utilization of existing structures, and mean more job generation. For the incentives to be really useful to small business, we feel that the legislation must particularly focus on capital formation issues, and that any tax incentives must be refundable.

Our specific recommendations on labor-related incentives are as follows:

1. Employer Refundable Income Tax Credit (5% CETA-Eligible)

   As suggested in the Kemp/Garcia bill of 1981, we favor refundable business income tax credit equal to at least 5% of wages paid to CETA-eligible workers. It should be noted, however, that this is a rather weak incentive both to locate in the E.Z. and to hire CETA-eligible. An annual salary of $10,000 would imply a $500 incentive to the employer, on an hourly basis, it would reduce a wage of $5.00 to $4.75. We do not favor the Administration's proposal in this area which is nonrefundable.

2. Employee Refundable Income Tax Credit

   As suggested in Kemp/Garcia, we favor at least a five percent refundable income tax credit for all zone employees (in eligible businesses) up to $1500 per person. We favor refundability and the $1500 limit, in contrast to the Reagan Administration's non-refundability and $900 limit. We feel that the nonrefundable feature would discourage low income workers, many of whom would have very low taxes in any case. As far as the income limit is concerned, the $900 limit would mean that only wages up to $18,000 would be effected, while the $1500 limit would raise the threshhold to $30,000. The higher limit would allow better recruitment of facilities with more middle management positions and moderate skill levels. We also feel that the criteria for eligible businesses as those with 40% CETA - eligible is unrealistically high; we would suggest reducing the criteria to 10% and providing higher credits and limits for those employing more CETA-eligible.

We do not favor use of the Targeted Jobs Tax Credit (as suggested in the Rangel bill) or a Youth Minimum Wage Differential, which was suggested in earlier Administration drafts.

We feel that the capital related incentives are of great interest to small business. Our recommendations are:

1. Capital Gains Taxes Reduction/Elimination

   We generally favor a capital gains tax reduction or elimination for firms within the zone, as noted in Kemp/Garcia and the

Administration Plan. In light of the broad erosion of jobs from the E.Z. zone and the tendency of modernization to reduce total labor input, we feel that it would be realistic to reduce qualification from 10% employment addition (as in Kemp/Garcia) to maintaining present employment.

We believe that the potential for capital gains tax advantages can be an important incentive in attracting developers and investors who want to build or to rehabilitate buildings for lease. This potential source of investment funds should not be unduly restricted in the E.Z. in light of this extreme deterioration of many parts of the E.Z. We do not believe that the buying and selling of property for tax cuts is a major problem; not only is it unlikely to occur in substantial numbers, but even if it did, it would create greater liquidity (thus reducing risk) in distressed areas. The tax advantages of capital gains provisions could be broadened by liberalization of what qualifies for capital gains treatment through the elimination of some recapture rules.

2. Business Income Tax Reduction

We favor no income tax on 50% of business income of zone business, as in the Kemp/Garcia proposal (see also Net Operating Loss Carry-Forward). This provision, when combined with the carry-forward, is important to many entrepreneurs.

3. Income Tax Reduction for Interest for E.Z. Loans

We also favor no tax on 50% of interest earned on loans within the E.Z. We feel that the interest deductions should be applicable to SBA guaranteed loans to help SBA 503 companies lower the cost of capital in E.Z.

4. Investment Tax Credit/Rehabilitation Tax Credit

We favor an investment tax credit similar to that favored by the Administration Plan, provided that the ITC is refundable. The proposal says that: (1) for property depreciable in 3 years, this credit is 3%; (2) for property depreciable in 5 years, this credit would be 5%; (3) for the construction or rehabilitation of commercial, industrial or rental housing structures within the zone, the investment tax credit would be 10%. The provision that the machinery and equipment eligible for the credit must be used in the zone for all of its depreciable life may tend to reduce the value of this provision to small business which tend to use more used machinery and equipment. No ITC's for commercial or industrial facilities are available in the Kemp/Garcia bill; and ITC for rental housing is available under the bill.

5. Net Operating Loss Carry-Forward

We favor extension of the net operating loss carry-forward provisions of the E.Z. to 20 years (as suggested in Kemp/Garcia and the Administration Plan) from 15 years in the 1981 Economic Recovery Tax Act. We do not feel that this provision will be a major factor in encouraging new small business because most small businesses do not have a 15 or 20 year time horizon over which they plan their taxes.

6. Industrial Revenue Bonds

We favor raising industrial revenue bond ceilings within E.Z. Qualified businesses should be allowed use of IRB's without dollar limit within E.Z. Other firms should be allowed up to $25 million in IRB's (and $35 million with UDAG). We also favor suspension of loan guarantee prohibitions within E.Z. for SBA qualified businesses.We also favor the ability to pool small issues of IRB's. If IRB's are eliminated elsewhere, as proposed by the Administration, we favor their retention in the E.Z.

7. Cash Accounting

We favor allowing cash accounting for new businesses as suggested in the Kemp/Garcia bill. We prefer to use criteria of "annual gross receipts less than $2 million", as suggested by Kemp/Garcia rather than SBA small business designation. This provision is directed at assisting new, nonincorporated businesses.

8. Small Business Participating Debentures (SBPD)

We generally favor SBPD's as a capital formation device for small business. If legislation for SBPd's is not passed, we would suggest using E.Z as an experimental case for the mechanism. This has not been suggested in any E.Z. legislation to date.

9. Refundable Real Estate Tax Credit

We favor allowing Federal tax credits for local property taxes of 20% within E.Z. in addition to property tax deductibility. Up to 30% of the real estate tax credit should be refundable, but this should not exceed $50,000 in any one year. This provision, which is not in any E.Z. proposal, would have the effect of making central city tax burdens more competitive with those of industrial suburbs.

In terms of land-related incentives, our recommendations are as follows:

1. Community Development Block Grant (CDBG) and UDAG Targeting

We favor targeting of a portion of Community Development Block Grant and UDAG funds to the E.Z. to solve several land-related problems of distressed area development. The funding could help reduce the cost, difficulty, and delay of land transfer and assembly, and improve local infrastructure and services. This is similar to the Kemp/Garcia bill's general provisions directed at coordinating all federal housing, community and economic development and other programs within the zone. The Administration's plan notes that cities might be expected to use their own community development block grants or UDAG's on the E.Z. in the competitive process for designation.

2. Foreign Trade Zone Designation

   We generally favor the Administration's proposal for designating the E.Z. as "foreign trade zones", but feel that this is not a provision of wide applicability. Within these zones, the imposition of all duties and tariffs is delayed until the imported goods leave the zones for the domestic U.S. market.

In regard to coordinating management assistance program, we have the following recommendations:

1. SBA Targeted Management Assistance
2. MBDA Targeted Management Assistance
3. Other Commerce Programs for Management Assistance

   We favor provisions which direct government management assistance programs to place special emphasis on the E.Z. Because of the prevalence of new, small and minority-owned businesses in the E.Z., there is need to provide a high level of coordinated assistance. This is generally consistent with Kemp-Garcia, although that bill does not require an explicit commitment from these agencies.

Under the topic of regulatory reform, we have the following recommendation:

1. The relaxation of OSHA and EPA regulatory requirements at the request of state and local governments is suggested in the Reagan Adminstration Plan. While we favor continued improvement of the standards and procedures for compliance on a general basis, we do not feel that this incentive would be a significant factor in the E.Z.

In closing, we want to thank you for the opportunity to testify on behalf of the Council of Smaller Enterprises of the Greater Cleveland Growth Association and Small Business United. We hope that our testimony will be of help to you as you consider the Enterprise Zone concept. Thank you.

Mr. PANICHI. We are in favor of the legislation.

Senator CHAFEE. You are in favor of it?

Mr. PANICHI. Yes, we are. And we have just a couple of items. In order to make it work, it's got to be a total package, a total approach which addresses some of the specific barriers that face businessmen in declining areas.

We had a survey in Cleveland with over 1,000 companies, and we found that over 60 percent mentioned crime and neighborhood deterioration as barriers to expansion and job formation.

So, although we are in favor of it, we know this is not a cure-all. Enterprise zones alone are only a partial approach to the urban deterioration.

Because of my background, I obviously am interested in the areas that provide capital formation.

Senator CHAFEE. Yes. Do you have any suggestions on that?

Mr. PANICHI. Well, yes. If I can just quickly address them, some of the major ones are: capital gains reduction or elimination for firms within the zone, as noted in the Kemp-Garcia and the administration plan, is desirable.

We favor the investment tax credit similar to that favored by the administration plan, provided, though, that the investment tax credit is refundable. And that's a major issue.

In addition to that, we also favor the following provisions for enterprise zones, such as: no income tax on at least 50 percent of the business income and/or the interest earned in enterprise zones; extension of your net operating loss carry-forward provisions; raising the industrial revenue bond ceilings in enterprise zones; allowing cash accounting for new small businesses; allowing small business participating debentures; allowing Federal tax credits for up to 20 percent of the local property taxes; targeting community development block grants and urban development action grants to the enterprise zone; and designating enterprise zones as foreign trade zones; targeting Small Business Administration and Minority Business Management Assistance programs to the enterprise zones.

The most important aspect is that the items that we referred to be refundable as opposed to nonrefundable.

Senator CHAFEE. That's a sticky one. I have a lot of trouble with that one. One suggestion is the writeoff of expenses the first year. But the refundability, I think we have a lot of problems with.

Mr. PANICHI. The rationale for that is the areas, at least in Cleveland, where we would like to see the investment to be made, is high risk. And venture capitalists who are going to take high risk would like a return rather quickly.

Senator CHAFEE. Well, they would get that with the writeoff.

Mr. PANICHI. The writeoff is not quite as—it's just a question of degree of how quickly you would want it.

I did a pilot study on this with a legitimate firm, and I did test it with one of our brokerage houses. I would be happy to share it with you at some time.

Senator CHAFEE. All right. Well, thank you very much.

Mr. PANICHI. Thank you, Senator.

Senator CHAFEE. I appreciate your coming.

We will conclude the hearing now. Thank you.

[Whereupon, at 1:57 p.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

TESTIMONY BEFORE THE

SAVINGS, PENSIONS AND INVESTMENT POLICY SUBCOMMITTEE

OF THE

SENATE FINANCE COMMITTEE

ON

ENTERPRISE ZONE PROGRAM

BY

WILLIAM LUCY,

INTERNATIONAL SECRETARY-TREASURER

AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES

APRIL 21, 1982

Mr. Chairman and Senators, my name is William Lucy, and I am Secretary-Treasurer of the American Federation of State, County and Municipal Employees. AFSCME represents more than one million public employees, many of whom work for cities and counties that would be eligible for Enterprise Zones.

Let me begin by making it clear that we oppose the Administration's proposal. At best, the proposal is a misguided ideological attempt to solve a very serious problem. At worst, it is a cruel charade designed to cover up this Administration's callous disregard for our cities and its failure to present any positive program in this area. The fact of the matter is that you cannot substitute $310 million in tax subsidies for $8 billion in cuts that this Administration imposed on programs designed to help distressed areas and provide decent local services.

We oppose the Enterprise Zone bill not only because it is an inadequate and simplistic response to an enormous and complex problem; we oppose Enterprise Zones because we believe they will not work and we specifically oppose this bill because it has features in it which will exacerbate and compound the problems of deteriorating areas.

In announcing this Enterprise Zone proposal, the President said the goal of the program is to "create jobs and expand economic activity." However, there is nothing in the bill which would either create employment or expand commerce.

It is now a well established fact that small businesses are the largest source of new jobs in our society. Studies have documented that upwards of two-thirds of the jobs created in this country come from small businesses. Yet, there is little, if anything, in the Enterprise Zone proposal to help small businesses establish themselves and grow.

It should be obvious to anyone that the most serious and pressing need of small businesses is venture capital, so that earnings can be ploughed back into the enterprise during the first crucial years of operation. The current legislation provides no source of venture capital which would allow small businesses to get off the ground.

The tax incentives provided in the Administration's proposal will not matter to small businesses. To begin with, most new small businesses don't make enough profit to pay a significant amount of taxes. In fact, only forty percent of them are incorporated and, hence, able to take advantage of these tax breaks.

The Administration's response to the charge of lack of investment incentives is to point to the elimination of capital gains taxes which they claim will make investments in Enterprise Zone businesses attractive. Here, however, the Reagan tax cut to upper income individuals and wealthy corporations comes back to haunt its creator. With all the tax shelters provided by last year's tax bill, few investors will put their capital into a risky small business in a distressed and decaying area when so many other more secure opportunities are available.

All of what I have said so far overlooks an even more basic point: that firms do not make investment decisions based on tax breaks. Businesses decide to locate in a certain area because they foresee a demand for their product, because there is an available work force which suits their needs, and because there is a reliable public infrastructure which provides adequate access to transportation, water, sewage, and police and fire protection. Taxes comprise only two to three percent of the cost of doing business for most firms and the net effect of most tax breaks for businesses is to subsidize investments which would have been made regardless.

Another reason why the Administration's Enterprise Zone proposal can't work is that it does nothing to address the skill problem of many of the unemployed who reside in these areas. There are absolutely no provisions for job training to replace the expired CETA program. While the Administration suggests that training programs on the local level will increase as a result of the competition for designation, the reality is that few local governments eligible for the program currently have room in their budgets for such programs. The problem of inadequate local resources will, of course, be intensified by the Administration's prodding of local government to provide tax breaks of their own in order to obtain Enterprise Zone designations.

With no federal funds for job training, little local money available and no requirement for any private sector commitment to training tax breaks, the chances are that the employment available to so-called "disadvantaged zone employees" will be unskilled jobs with low wages, few benefits, little job stability and scant opportunities for advancement.

The Enterprise Zone bill contains no prohibitions on firms transferring existing facilities to zones without any expansion of employment or improvements in productivity. Thus, it is likely that any gain in employment into enterprise zones will come at the expense of surrounding areas. The net effect of the enterprise zones will therefore be similar to the results of last years business tax cuts. The government will lose substantial tax revenues, but no new jobs will be created.

The Administration's bill also contains a provision which can only be interpreted as an insult to public employees. The Administration proposes to use the extent to which a locality "privatizes" or "contracts out" public services to private companies as a criteria for awarding enterprise zone designations.

The administration cavalierly, without any documentation, assumes that the private sector can perform public services better than public employees. The Administration's position is based more on rigid ideological belief than an examination of the facts. Our experience with contracting out convinces us that in the long-run the public gets less for its dollar when private entrepreneurs are allowed to turn public needs into opportunities for private greed. In most cases when local government services are contracted out, the level and quality of public services decreases, and in almost all cases the responsiveness of the services to the public diminishes. To be sure, occassionally labor costs can be temporarily reduced by replacing permanent unionized public personnel with low paid transient private workers. However, in the long-run the public pays for the differences in poorer services and increased opportunities for corruption that almost inevitably follow opportunities to award highly profitable lucrative contracts.

Lastly, one of the most serious concerns we have with the Enterprise Zone bill concerns the nature of the competition between governments for designation as"zones." There is a dangerous "Catch-22" involved in the designation process. Only those areas which offer the most attractive or most expensive package of tax breaks, regulatory relief and privatization of public services will be awarded "Enterprise Zone" status. The result of this tax competition is that local public treasuries will be further strained and the ability of local governments to provide adequate public services and maintain a viable infrastructure will be further diminished.

In our opinion, the key to revitalizing distressed areas is the restoration of adequate public services and the rebuilding of public facilities. It does not take a genius to figure out that private investors will be reluctant to invest in high crime areas without assurances of adequate police and fire protection. It also should not take a PH.D. to figure out that investors will be extremely hesitant to build plants in areas which connot guarantee the maintenance of necessary water supplies, sewage facilities or roads that any modern facility needs to function. Marginal tax breaks are no substitute for essential services. Yet, this Administration's policies are making it more difficult for states and their localities to provide services which are the absolute preconditions for sustainable economic growth.

In summary, the Enterprise Zone bill lacks the elements necessary for economic recovery and the creation of jobs. It makes no provision for venture capital, the major requirement of small businesses which create most jobs. It provides tax incentives only for large companies who will not use them unless they have already decided to invest. It makes no provision for job training for the structurally unemployed. It does nothing to help financially strapped governments maintain public services or rebuild their roads and bridges and sewer systems and public transit. It asks these governments to engage in destructive competition for investment and to suspend regulations that were enacted to protect their citizens.

In short, we believe that the Administration is once again using the supply side pipe dream as a smoke screen for futher business tax cuts and a lack of any positive program for economic growth. Last year, the Congress was promised a return to prosperity if it enacted the tax cuts proposed by this Administration. Unfortunately, the Congress followed blindly and rubber stamped the Administration's proposals. The result has been economic disaster rather than economic growth. We believe the enactment of this legislation will do as much for distressed areas as last year's tax bill did for distressed industries. We ask you not to repeat the mistakes of the immediate past. We ask that in considering this legislation you look at the facts and exercise prudent judgment. We are convinced that if you do that you will give this legislation the burial it deserves.

STATEMENT OF
NATIONAL FEDERATION OF INDEPENDENT BUSINESS

SUBMITTED TO:	Senate Small Business Committee
DATE:	April 26, 1982
SUBJECT:	Enterprise Zones

Mr. Chairman, I am Wilson S. Johnson, President of the National Federation of Independent Business (NFIB), with an audited membership of 505,207 small business owners across the nation.1/ On behalf of NFIB's members, I would like to thank the Chairman for this opportunity to express our views on the subject of enterprise zones.

NFIB has monitored closely the development of the enterprise zone concept since it was brought to the United States by Stuart M. Butler shortly after its inception in the United Kingdom. The British devised enterprise zones as an experiment to try and restore the deteriorated portions of that nation's inner cities. Believing that Britain's inner cities were declining in large part as a result of public policy decisions, such as strict regulation and high taxes, government officials adopted a utilitarian approach--the enterprise zone--which encompassed minimal government involvement, significantly reduced regulation and low taxes. The British experiment, begun in the summer of 1981, has not been in effect long enough to measure its impact. Nevertheless, the enterprise zone concept has already received a great deal of attention and support from government officials, urban policy experts, and other concerned groups in our own country.

Butler refined the enterprise zone idea for application in the U.S. by incorporating into the concept the work of David Birch at MIT, which empirically demonstrates that small, not large, businesses are the nation's job creators.[2] Particularly important to Butler's purpose, Birch produced compelling evidence that the number of jobs lost (as a percentage of the labor force) to layoffs, business failures, etc. was virtually identical in any city, be it flourishing or depressed. The real difference between economically healthy and unhealthy cities was the rate at which new small businesses were created.[3] Based on Birch's work, Butler concluded that the success of an enterprise zone would be dependent upon heavy stimulus to the creation of small businesses rather than incentives for larger entities.

In addition to Birch, Butler has espoused the ideas of sociologist Jane Jacobs[4] regarding the necessity for neighborhood cohesion, cooperation, support, attitudes, etc., as being vital to the restoration of inner cities. To Butler--and to many others as well--the importance of creating small businesses and the necessity for preserving neighborhoods go hand in hand: hence, his concept that the ideal enterprise zone would be one in which small businesses were owned and operated by residents of the community rather than being imported from elsewhere.

In its original form, Butler's Enterprise Zone was comprised of three equal parts--experimentation in reduced government, small business, and neighborhood. What has evolved, however, is a very different equation. The idea is no longer viewed as an experiment, but as the proposed national urban policy. The proposals which have evolved out of the original concept do not center around the creation of small business, but simply business in general. Finally, the concept of neighborhood preservation and revitalization has been lost in the shuffle. What remains is a package of tax "incentives" and good intentions.

NFIB polled its membership on two separate occasions on enterprise zones. Both times (September, 1980 and June, 1981), the response was precisely the same--and overwhelmingly negative (27% for, 62% against, 11% undecided). If small business--the catalyst for success in Butler's original concept--is so decidedly against the enterprise zone, is this not an indication that something has gone awry between the conceptual and the developmental stages?

Two basic questions need to be asked before any enterprise zone proposal is enacted: Who are the entrepreneurs; and what are the most important problems facing urban entreprenuers in starting a new business? NFIB's research provides answers to both questions.

Anyone can be an entrepreneur, but certain characteristics seem to be common to the breed in general.

For example, they are better educated than the public as a whole; they are overwhelmingly male and disproportionately Caucasian; they tend to start between the ages of 25 and 40; entrepreneurship tends to run in families--children of an entrepreneur, successful or not, have a much higher propensity to enter their own business; they are moderate risk-takers--neither "river boat gamblers" nor "stick in the mud" status quo types; their motivations are varied--personal independence, the need to build more income, etc. Nevertheless, for what we know of these general characteristics, there is not even a quasi-reliable means of preselecting or pre-screening any individual as a successful entrepreneur.[5]

These entrepreneurs enter their businesses in one of four ways. There is obviously more than one means of entering one's own business. For present purposes, we are not interested in the inherited, purchased, or brought into ownership forms, although the latter two might be used in a Zone. The focus is on starts.

Recently, NFIB asked a sample of its urban members to outline the problems they encountered going into their businesses.[6] Aside from the fact that starters reported more problems than did those entering by other means, people entering business in this manner identified four particular problem areas: learning how to run a business, adequate financing, low initial sales, and finding a good affordable location. All four were ranked almost identically. Locating qualified employees ranked in the middle. Taxes, local zoning, regulations, licenses, finding suppliers, and marketing and advertising clustered at the bottom.

Let us examine each of the four most serious in more detail. Outside observers, particularly academics and Dun and Bradstreet, tend to place considerably more emphasis on management than do operating entrepreneurs. The difference is not surprising, given the fact that many practioners are natural managers and were queried on their own experience in contrast to the more universal view of outside observers. What is surprising is that successful entrepreneurs identified "learning how to run a business" with such frequency. Figures such as 9 of 10 small businesses fail due to management deficiencies abound. While these figures are open to very serious questions on a number of counts,[7] both practioners and observers agree that management is critical.

It is little wonder that start-up and working capital in the first several months, i.e, low initial sales, plague the aspiring entrepreneur. Sixty percent have personal resources as their principle source of capitalization;[8] just over one of five have lending institutions as theirs, although we have no idea how many unidentified second mortgages are involved; friends and relatives account for another one of ten; government and venture capital firms combined constitute a bare 1%. In effect, starters use their own money, their own sweat, and their own ingenuity to finance their ventures.

Anyone familiar with small business will not be surprised at the virtually non-existent role of venture capital and government programs and the limited role of investors in new business formations. For the population as a whole, these sources are relatively non-important. But the relatively limited role of lending institutions may raise eyebrows. It should be noted at the outset that a healthy majority of starts have some money from a lending institution. (Curiously, small banks accept about half of their new business loan applications and enjoy a relatively low loss rate on them.[9] In contrast, large banks reject three of four and have a much higher loss rate on the limited number they accept.) Suggestive data and anecdote lead us to believe a large share of these loans are personally collateralized.[10] In other words, while debt financing from a lending institution is often available to some extent, it is frequently little more than an extension of personal resources.

Finding a good, affordable location was the fourth major problem identified by entrepreneurs as a major start-up difficulty. Here we touch the question of location and relocation decisions.

There is a surprising amount of personal relocation occurring among urban entrepreneurs for the purpose of business entry (16%).[11] Almost all is short distance. However, virtually none of this personal relocation is for the purpose of a start-up. That means a newly formed business is almost always within commuting distance of the founder's home. While commuting distance can be substantial, it is more likely than not, given the personal time required in business initiation, that the commute is quite short.

It is important to recognize, however, that small businesses are not static. In fact, 60% of urban entrepreneurs have either changed location after business entry or have added a second location. Almost half have changed their original location.

The reason for relocation or expansion to a different location invariably involves market opportunity.[12] Space (facilities) and personal reasons are considerably down the line in frequency as a motivating factor. Government incentives are almost never a major factor. The converse, of course, is that non-movers remain for the same reason movers move. It's the market, although in deteriorated neighborhoods the cost of moving is even more important. Relocation is an expensive proposition and not to be taken lightly.

It's no secret there are more favorable and less favorable environments for operation of a small business. In the recent NFIB study on urban small business, those environmental differences were underscored. The study presented respondents 25 potential problem areas and asked them to rank the severity of each. Answers were then divided into three classes: those from entrepreneurs located in "attactive" neighborhoods, "average" neighborhoods, and "run down" neighborhoods. Comparing answers between those located in average neighborhoods and run down neighborhoods, it was discovered that 18 of the 25 problems assessed were more severe (statistically significant) in the run down neighborhoods. The largest differences were recorded in "Crime Rates," "Local Inspections and Inspectors," "Cost of Insurance," "Unfavorable Business Location," "Obtaining

Needed Loans," and "Locating Qualified Employees." Shaping the contrast further, the study examined those seven problem areas where no differences existed-- "Employee Turnover," "Local Tax Rates," "Ease in Getting Licenses/ Permits," "Lose Skilled Employees to Larger Firms," "Cost of Labor," "Cost of Rent," and "Low Profits."

The impression we are left with is clear, unpleasant, and not surprising. The disincentives for locating a new business in a depressed area are numerous and large. The labor pool lacks skills, fixed costs such as insurance are high, crime is substantially greater than in other areas, the market has difficulty supporting those firms now established, etc. In short, depressed neighborhoods provide something less than a civil environment for the operation, let alone the institution, of a small business.

If distressed neighborhoods provide less than a civil environment, entrepreneurs should be able to tell us what would produce a more positive climate. Unfortunately, there is no systematic body of empirically based literature focusing on small business starts. The NFIB study previously noted and the management literature appear to be all that is available. However, various empirical studies of operating small businesses seem to point to factors other than direct tax incentives as desired and/or motivating factors. For example, a study of small businesses in New York (Queens) showed infrastructure and city services to be the primary concern. Another study of small businesses relocating from Milwaukee's central city to the suburbs showed the market and transportation (highways) to be critical.[13] Still a third found small businesses following people and in some cases larger businesses--all of which relate to sales and the market. Finally, a staff study for the Joint Economic Committee found direct financial incentives of low priority to small entrepreneurs in 10 surveyed cities.[14]

One of the best kept secrets with respect to small business is the population and its distribution. You have probably seen the figure--14 million small businesses. SBA uses it as does practically any small business speaker I have ever heard. Fourteen million is not an inaccurate figure if: 1. part-time entrepreneurial activity reported to the IRS is included, e.g. the Avon lady, the student who takes in typing to put himself through school, the teacher who paints houses during the summer, the factory worker who drives a cab at night, etc.; 2. all farms (production agriculture) are counted; and 3. all full-time self-employed individuals who do not employ others are incorporated in the total. That leaves approximately 3.7-3.8 million businesses that employ people.

Nearly 70% of the small businesses that employ people are to be found in the labor-intensive retail and service sectors; less than 10% are located in manufacturing. No point is more critical to understanding Enterprise Zones than is the latter.

The ideal types of businesses for location in an Enterprise Zone would be retail or service firms. They are the most populous. The cost of start-up, particularly for a service firm, is relatively low.

They are labor intensive. Employee skills required, particularly for a retail firm, tend to be low. Minority entrepreneurs have the greatest experience in these sectors. Retail and services firms fit into the neighborhood with minimal disruption.

There is only one problem--no market. Small retail and service businesses are fundamentally dependent on the immediate neighborhood for sales. (If an untapped market does exist that could be filled by new businesses, why has it not been filled to date?) Without additional people or income entering the Zone (not necessarily residents), there is no base on which to build a business. No reduction in government (within reason) can create a market where one doesn't exist.

Essentially, what is required is an "export" business--a business that sells outside the Zone. Income is thereby drawn from other parts of the city, SMSA, etc., back to the Zone in the form of wages, and hopefully, profits and local purchases. Unfortunately, there is a problem. Unless the Zone is to become a warehouse district which directly violates Butler's idea of neighborhood, one is fundamentally left with manufacturing operations. But what made retail and service business so attractive in the Zone is absent in manufacturing. There are relatively few of them and their population is declining. Their start-up cost is comparatively high. They are capital intensive. Employee skill levels tend to be relatively high. Minority entrepreneurs have least experience in manufacturing. Manufacturing firms are so attractive that Zones will be competing with affluent areas for them. This inherent contradiction is the reason Enterprise Zones will not work: one segment of small business fits the Zone, but the zone doesn't fit it; the other segment of small business doesn't fit the Zone, but the Zone fits it.

Thank you.

ENDNOTES

[1] Membership total as of December 31, 1981. The audit was conducted by Goss & Marcussen, Certified Public Accountants.

[2] David Birch, The Job Generation Process (Cambridge, Massachusetts: M.I.T. Program on Neighborhood and Regional Change, 1979).

[3] David Birch, The Process Causing Economic Change in Cities (Cambridge, Massachusetts: M.I.T. Program on Neighborhood and Regional Change, 1979).

[4] Jane Jacobs, Great American Cities and The Economy of Cities (New York: Random House, 1969).

[5] How Small Businesses Begin, unpublished study, NFIB, 1980.

[6] Thomas C. Dandridge and William J. Dennis, Jr., NFIB Report on Small Business in America's Cities (San Mateo, California, NFIB, 1981).

[7] See, for example, Stahrl Edmunds, W. "Differing Perceptions of Small Business Problems", American Journal of Small Business (Baltimore: University of Baltimore), Vol. III, Number 4 (April, 1979).

[8] How Small Businesses Begin, unpublished study, NFIB, 1980.

[9] Cynthia A. Glassman and Peter L. Struck, "Survey of Commerical Bank Lending to Small Business", Studies of Small Business Finance (Washington, DC: Interagency Task Force on Small Business Finance, 1982).

[10] NFIB, Credit, Banks and Small Business, unpublished survey, 1980.

[11] NFIB, Report on Small Business in America's Cities.

[12] Ibid.

[13] R. A. Erickson, "Environment as 'Push Factor' in the Suburbanization of Business Establishments," Urban Geography 1(2)(1980).

[14] Joint Economic Committee, U.S. Congress, Central City Businesses--Plans and Problems (Washington, DC: GPO, 1979).

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TESTIMONY SUBMITTED TO THE
FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

On

ENTERPRISE ZONES

By

Speaker Pro-Tem Barry Kutun

Florida House of Representatives

on behalf of

THE NATIONAL CONFERENCE OF STATE LEGISLATURES

April 21, 1982

Mr. Chairman and members of the subcommittee, my name is Barry Kutun. I am Speaker Pro-Tem of the Florida House of Representatives. I am pleased to have the opportunity to address you today on the topic of enterprise zones. Florida is an obvious supporter of the concept having passed a package of measures to aid the Liberty City area of Miami in June of 1980 and having revised that package just this year to more closely reflect the enterprise zone concept. Since passage of those bills nearly two years ago, 17 slum or blighted areas have been designated as zones.

Nationally as well, the National Conference of State Legislatures has supported enterprise zones as a tool to target resources from all levels of government to areas of particular distress. Legislation has already been adopted in Connecticut, Maryland, Louisiana, Ohio, Kentucky, Virginia, and Minnesota in addition to my own state of Florida. Indiana, Oregon, and Illinois have also set up study commissions to evaluate enterprise zones and consider legislation for future action. Enterprise zone bills are also under consideration in many other legislatures throughout the country. NCSL has an ongoing project assisted by HUD to evaluate enterprise state zone legislation passed to date. The results of this project will be compiled this summer and made available to the subcommittee.

One statement of qualification should be made initially, however. Just as states see enterprise zone legislation as an additional tool to target state and local resources, the federal government and the Congress should not view enterprise zones as a substitute for existing urban and rural aid programs. Even in a time of reduced resources, there appears to be general agreement that enterprise zones cannot be viewed as a panacea and that other programs to provide infrastructure assistance, venture capital, enhanced public safety, and job training need to be provided by all levels of government.

This notion of combined effort is essential to the success of an enterprise zone program. Areas which display the symptoms of distress contained in this legislation need the assistance of any and all the resources available from both the public and private sectors. NCSL clearly supports local government as the day to day manager of zone activities and coordinator of neighborhood and private sector efforts. It is vitally important, however, that state governments be involved in the design and structuring of zone incentives.

State governments have a substantial stake financially as well as their concerns for the welfare of their citizens in the success of any enterprise zone. There is no doubt that the failure of any revitalization effort carries enormous costs in both financial and human terms. For this reason, NCSL strongly supports the combined state-local application process. Although negotiations between states and localities may not always be the path of least resistance, the process of joint examination of the problems involved and avenues possible for addressing them will result in benefits regardless of whether an enterprise zone application is ultimately approved by the federal government. It is also clear to me as a state official that despite disagreements between state and local offficials over the best package of incentives, no state would deny a depressed local government the opportunity to seek assistance. The proposed cooperative arrangement appears to be the most effective way of ensuring a coordinated package of state and local incentives.

Over the course of the development of this legislation and through your hearings last July, the subcommittee has heard from numerous experts in business taxation on the effectiveness of the individual tax incentives offered in this legislation. I am not a tax expert and will not attempt to analyze the proposals individually. I would like to address several principles which I believe should guide your design of these proposals.

In Florida, we provided a credit against the corporation income tax for up to 25% of the wages of new employees whose monthly wages did not exceed $1500. A credit is also available against the state corporation income tax for new or expanded businesses up to $50,000 per year. These two credits are available only to businesses in "slum and blighted areas." We also enacted tax credits for businesses which contribute to community improvement projects and created a loan and grant program for community development corporations.

This loan and grant program has proved to be the most successful of our efforts. As a result of the infusion of funds into fledgling community development corporations, projects such as a food cooperative and nursery have begun in the Liberty City area of Miami with the assistance of local businesses who receive tax credits for their contributions.

Although tax credits are not the only answer we believe the encouragement of expansion and contributions to the neighborhood are of particular importance. Tax credits alone have also come under question as the most effective business inducement. Business climate and the quality of government services are being recognized as increasingly important, particularly given the growing concern over the shifting of jobs rather than job creation.

NCSL could raise some questions as to the effectiveness of tax credits in addition to those tax concessions offered across-the-board as part of the Economic Recovery Tax Act and the enforceability of recapturing the investment tax credit if equipment is removed from the zone. We would also ask reconsideration of the nonrefundability features of the Administration's proposal. We believe the refundability of tax credits under S. 1310 would more effectively assist those businesses with low or nonexistent tax liabilities for their initial years. Admittedly, this feature would increase the initial cost of the zones to the Treasury, but if the potential of enterprise zones is even partially realized, this loss would be short-term. We would also urge the retention of the incentives for lenders contained in S. 1310. One need often expressed by enterpreneurs is the availability of affordable capital. I believe the incentives in S.1310 or similar incentives designed to address this need would be beneficial.

One comment might also be appropriate relating to the use of industrial development bonds in zones. Many states have effectively helped small businesses through the use of umbrella industrial development bonds packaging a number of very small loans into a marketable securities instrument. These umbrella bonds have come under attack by the Internal Revenue Service and have been the topic of Congressional debate. In order to meet the needs, particularly of small businesses, any exemption for the use of industrial development bonds in enterprise zones should also include the ability to package zone projects into these umbrella bonds.

One of the primary concerns of state legislatures with the proposed legislation is naturally the state and local government commitments. Although the exact nature of these commitments is not spelled out in the federal legislation, summary documents distributed with the Administration's proposal indicate a number of areas which would be judged strongly in any competition for zone designation. NCSL applaudes the flexibility given to the states and localities but must raise one significant overall question with regard to the process. There should be no doubt that many of the state and local tax incentives and deregulatory components contemplated by this legislation are controversial. If they were not they would have already been enacted by many states. As a state legislator speaking to a federal legislator, I think you can appreciate the difficulty of enacting controversial changes in statutes in order to be able to apply for one of twenty-five enterprise zone designations.

I would urge you to consider a pre-application stage to the process where a package could be proposed and negotiated. Should the package be acceptable and the area designated a zone, increased pressure would result and many controversial items would more likely be enacted if a zone were guaranteed than would be passed in order to apply. Should the legislature or city council not adhere to the package agreed upon within the next legislative session or reasonable time, the designation would be shifted to another city or area. We believe this change or some other method of addressing this problem would speak to the concern for enforceability of the guarantees and perhaps result in a better package than would otherwise be politically possible. I also believe this addition would address local government concerns over any gaps in state statutory authority preventing local participation in the program.

In looking at the state and local contribution question, I would also strongly endorse the evaluation of a zone application based on the fiscal capacity of both the locality and the state. Florida has been an area of substantial growth but even within our economic climate our growth has been uneven both over time and geographically within the state. This situation is more acute in states harder hit by the current recession. This consideration should also not be confined to the fiscal capacity to provide tax relief, but also to a locality's ability to provide additional services or infrastructure.

Given the fiscal situation of areas such as Miami-Dade County, the local government cannot always be expected to expand services and many state governments as well are not in a financial condition to provide massive infusions of direct state aid. Playing the role of catalyst and packager to address a crisis situation initallly and later adding longer term assistance seemed to be the most effective state role.

NCSL also has concerns over some of the areas emphasized in summary documents as guides to successful applications. Despite the acceptance of the premise that flexibility will be the key, some of the areas clearly do not seem appropriate. I would call to your attention as an example the encouragement for legislatures to lift usury ceilings only within enterprise zones. In Florida, as in many other states, usury rates have been an area of legislative concern and their impact on the availability of credit considered.

It would seem to me, however, that it would create a great regulatory burden on financial institutions as well as zone businesses to have loan rates vary geographically. In evaluating this and other deregulatory components, we believe the workability of the proposal and resulting increases in administrative complexity for both government and business should be considered. This principle might also be applied to the ability of localities to engage in extensive privatization of municipal services under existing public employee union contracts.

Maximum flexibility in dealing with these questions during the course of the zone designation is important as well. State and local governments should be provided the opportunity to evaluate the progress of the zone and make adjustments to increase incentives in those areas proving effective and eliminate those which are not and therefore acting as a needless revenue drain. Under controlled conditions and with proper guarantees to existing businesses, the ability to terminate zones should be considered. Just as the controls are placed within your federal legislation to minimize the tax loss to the federal treasury, states and localities need to be assured that they too will be able to control their revenues and allocate their resources appropriately.

Mr. Chairman, I hope these comments although general have proved helpful. Enterprise zones as with most new ventures are not without pitfalls. We in Florida have had to make adjustments to our laws as have several of the states with enterprise zone bills. I hope in designing federal legislation you can benefit from our experience. Again, we believe there is substantial merit to the enterprise zone proposal and will continue to work with you to make the concept an effective and workable way of helping distressed communities.

STATEMENT OF
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, UAW
TO THE
SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY OF THE SENATE COMMITTEE ON FINANCE, ON S. 2298, THE ENTERPRISE ZONE ACT OF 1982

May 5, 1982

The UAW opposes the "Enterprise Zone Act of 1982," which would set up special zones where firms receive federal, state, and local tax concessions and regulatory relief. These tax concessions would add to the huge giveaways provided by the 1981 Tax Act, further eroding business's contribution to federal government revenues. Regulatory relief would diminish hard-won government standards and safeguards.

New jobs are an avowed goal of this proposal. Yet we see no promise of enterprise zones becoming the cradle of new ventures and additional jobs. No start-up capital assistance would be made available; and the tax benefits offered would only favor those businesses making a profit. Any "new" jobs in the enterprise zone would most likely be the product of firms shutting down plants somewhere else and moving, perhaps next door, into a zone. The problems created by these plant closings would be left behind.

Indeed, S. 2298 would institutionalize the "economic cannibalism" between states, localities, and neighborhoods which has been so disruptive to the lives of industrial workers and their communities. As stated in the President's Message to Congress on the Enterprise Zone proposal, the zones would be chosen on a competitive basis:

> "A key criterion in this competitive process will be the nature and strength of the state and local incentives to be contributed to the zones, consistent with the overall Enterprise Zone theme of creating an open-market environment by removing government burdens."

According to the Administration, there may be more than 2,000 cities and rural areas with enterprise zone eligible areas. At most 75 areas would be designated so that cut-throat competition is sure to develop among the areas. The consequences would be an eroded local tax base, relaxation of regulations (such as zoning and building code regulations), and the use of federal funds for urban development block grants or revenue sharing to upgrade services in the prospective enterprise zones.

According to CBO, the 1981 Tax Act will reduce federal revenues from corporations by $180 billion from fiscal 1983 through fiscal 1987. An additional 10 percent — or $18 billion — might be lost, according to the Joint Committee on Taxation, if the enterprise zone proposal is enacted.

This high cost would result from the outright elimination of taxes on capital gains, the doubling of the tax credit for investments made in an enterprise zone after it is so designated, and the payroll tax credits — or wage subsidies — to "qualified" emloyees. We note that employee "qualifications" do not require residency in the area, allowing for a situation of "guest workers" to develop. We also note that whatever small businesses existed in a zone previous to its selection as an enterprise zone would be disadvantaged, as it would be cheaper to start afresh there once the selection has taken place than for existing companies to continue their business.

The UAW is well aware of the desperate problems plaguing city after city in the nation's industrial belt. Most of the unconscionably high unemployment in places such as Flint, Michigan (21.9%), Detroit (16.4%), Toledo (12.6%), and Buffalo (12.5%) is made up of jobless auto workers and people previously working for suppliers to the auto industry, who have been victimized by the seemingly endless crisis in auto. The policies involved in enterprise zones, however, are yet another expression of supply side theories which might line the pockets of some already profitable businesses while doing nothing toward rebuilding our industrial base and providing new and permanent sources of jobs.

Rather than extending the trickle-down concept to our blighted urban and rural areas, there should be a strengthening of the federal programs that address directly the problems of unemployment, deterioration of services, infrastructure, and housing, and the lack of educational and training opportunities. The UAW is on record urging Congress to reject further cuts in social programs, allocate monies to rebuild the infrastructure, and fund training and employment programs. In addition, we are pressing for the preservation of investment incentives to currently unprofitable firms through refundability of investment tax credits and depreciation deductions.

The UAW urges this Subcommittee and Congress to reject the "Enterprise Zone Act of 1982."

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May 5, 1982
Statement of the

COMPONENTS GROUP
of the

Electronic Industries Association (EIA)
to the

Subcommittee on Savings, Pensions, and Investment Policy
of the
Committee on Finance

U.S. SENATE
on the

Enterprise Zone Tax Act of 1982, (S.2298)

Date of Hearings: April 21, 1982

The Components Group of the Electronic Industries Association (EIA) opposes the provision in the proposed Enterprise Zone legislation (S.2298) that encourages the establishment of foreign-trade zones within enterprise zones.

Three of EIA's Divisions comprise the Components Group. The Tube Division is composed of United States manufacturers of electronic tubes, including television picture tubes; members of the Parts Division are manufacturers of various passive and electromechanical electronic components; the Distributor Products Division's members are manufacturers of parts who sell all or some of their products through electronic distributors.

Title IV, Section 401 of S.2298 (attached) encourages the establishment of foreign-trade zones by directing the Commerce Department's Foreign-Trade Zones Board to "consider on a priority basis and expedite, to the maximum extent possible, the processing of an application involving the establishment of a foreign-trade zone within an enterprise zone..." The Bill further directs the Secretary of the Treasury to "consider on a priority basis and expedite, to the maximum extent possible, the processing of any application involving the establishment of a port of entry which is necessary to permit the establishment of a foreign-trade zone within an enterprise zone."

We believe such encouragement of the proliferation of foreign-trade zones would not be in the best interest of the United States for the following reasons:

1. Injury to U.S. Domestic Manufacturers

   Due to certain inconsistencies in the law, a phenomenon known as "inverted tariff" can be exploited through the establishment of a foreign-trade zone. In a number of instances, U.S. tariff rates are considerably lower on assembled products than on their components. For example, the tariff on typewriters is 0%, on automobiles is 2.9%, on TV sets is 5%; however, the tariff on their key components is in the 14%-18% range. In addition, if tariff is paid on the finished product, any value which was added inside the zone (i.e., the cost of assembly operations) is not subject to tariff. If foreign articles enter a zone or subzone as components and leave the zone as assembled products, the assembling party has the option of paying tariff on either the assembly (finished product) or the component parts. The combination of inverted tariff with assembly inside a foreign-trade zone is extremely disturbing because it encourages manufacturers to import components instead of producing or buying them domestically. It is noteworthy that this combination is being exercised primarily by foreign-owned subsidiaries domiciled in this country and operating within a zone or subzone. They use the foreign-trade zone mechanism to gain unfair commercial advantages over their domestic competitors and can cause substantial injury to U.S. manufacturers.

   In formal statements to the Foreign-Trade Zones Board, we have objected to such use of foreign-trade zones. We contend that when used in such a manner, foreign-trade zones become a device for the purposeful circumvention of U.S. customs duties and, thereby, for gaining unfair commercial advantages. Until such unintended use of foreign-trade zones is corrected, we feel that encouraging their proliferation is inappropriate and damaging to U.S. domestic manufacturers.

2. The Administration of Foreign-Trade Zones is Inconsistent with the Concept of Enterprise Zones

"The Administration's Enterprise Zone Proposal", page one, states, "Concept. The Enterprise Zone concept is based on utilizing the market to solve the problems of the Nation's economically depressed areas, relying primarily on private sector institutions. The idea is to create a free-market environment in these areas through the removal of taxes, regulations and other government burdens. The removal of these burdens will create and expand economic opportunity within the zone area, leading to the economic revitalization of these areas and to real, private sector jobs..." (emphasis added). The removal of government regulatory burdens is a laudable concept. We believe, however, that the administration and operation of a foreign-trade zone is incompatible with this concept. Application to become a foreign-trade zone involves conformance with many regulations and must include an explanation of planned operational procedures. Moreover, once an application has been approved, the administration of a foreign-trade zone is subject to numerous regulations controlling the flow of goods in and out of the zone. Foreign-trade zones are required to remain accessible to government officials at all times so that regulatory conformance can be verified. And these regulations cannot be waived; indeed, the majority of them are necessary and desirable.

It is our belief, therefore, that the encouragement of foreign-trade zones within enterprise zones is contrary to the concept of removing burdensome government regulation.

In the past two years, the growth in the number of foreign-trade zones has been dramatic. There are seventy three (73) zones plus ten (10) subzones. Their proliferation needs no encouragement. Most importantly, foreign-trade zones pose a threat to domestic manufacturers and, in the nature of their operation, are contrary to the underlying concept of enterprise zones. We believe the encouragement of foreign-trade zones is not in the best interest of U.S. manufacturers and that the combination of foreign-trade zones within enterprise zones is not in the best interest of the U.S. economy. We urge the Senate Finance Committee to remove from S.2298 any provision for foreign-trade zones or for ports of entry in conjunction with enterprise zones.

Attachment 1

S.2298

TITLE IV - ESTABLISHMENT OF FOREIGN-TRADE ZONES IN ENTERPRISE ZONES

SEC. 401 (a) In processing applications for the establishment of a foreign-trade zones pursuant to an Act entitled "To provide for the establishment, operation, and maintenance of foreign-trade zones in ports of entry of the United States, to expedite and encourage foreign commerce, and for other purposes", approved June 18, 1934, the Foreign-Trade Zone Board shall consider on a priority basis and expdite, to the maximum extent possible, the processing of any application involving the establishment of a foreign-trade zone within an enterprise zone designated pursuant to section 7871 of the Internal Revenue Code of 1954.

(b) In processing applications for the establishment of ports of entry pursuant to an Act entitled "An Act making appropriations for sundry civil expenses of the Government for the fiscal year ending June thirtieth, nineteen hundred and fifteen, and for other purposes", approved August 1, 1914, the Secretary of the Treasury shall consider on a priority basis and expedite, to the maximum extent possible, the processing of any application involving the establishment of a port of entry which is necessary to permit the establishment of a foreign-trade zone within an enterprise zone.

(c) In evaluating applications for the establishment of foreign-trade zones and ports of entry in connection with enterprise zones, the Foreign-Trade Zone Board and the Secretary of Treasury shall approve the applications to the maximum extent practicable, consistent with their respective statutory responsibilities.

Enterprise Zones: Area Designation is a Key to the Job Creation Process

by

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The Urban Institute

and

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A Statement Submitted to the

Subcommittee on Savings, Pensions and Investment

Committee on Finance
United States Senate

Hearings on Enterprise Zones, April 15 and 16, 1982

This statement is designed to make a single point, namely that the enterprise zone concept may have significant potential for aiding the distressed central cities of the nation in rebuilding their private employment bases; but this potential can be realized only if the concept is modified to allow development of large in-city industrial and office parks near to, but not actually within, residential neighborhoods. This argument will be developed in a step-by step fashion in order to clarify the reasoning underlying this conclusion.

The Potential Attractiveness of Enterprise Zones

Let us start by making a controversial statement which contradicts much of what has been said about enterprise zones: If the zones are to make a significant contribution to inner city economic development, they must be attractive to medium and large firms as well as to small businesses. While small businesses can and do make substantial contributions to employment and income in cities, they cannot be relied upon to carry the entire burden.

In recent years there has been much attention paid to what appeared to be the extraordinarily large proportion of new jobs that are created by small firms. Indeed, it has been estimated that small businesses create over two-thirds of all new jobs.[1] Recent evidence, however, suggests that small firms account for about 40 percent of all job growth--almost exactly proportional to their share of the private sector, paid labor force.[2] In light of this evidence, if the enterprise zones are to make a significant contribution to inner city economic development, they must be attractive to medium and large firms as well to small businesses.

Three other factors reinforce the need to attract larger firms. First, what cities need in terms of new employment are permanent jobs; the high mortality rate of small firms means that many of those jobs are of short duration.[3] Second, what cities need in terms of new employment are jobs of reasonable quality, which encompass such characteristics as wage levels above minimum wages, training opportunities, and advancement opportunities; and many of the jobs offered by small firms are of low quality in terms of these characterisitcs. Third, when a small firm survives and starts to grow--at precisely the moment at which its job generation potential is highest--it will tend to move out of the enterprise zone and out of the city unless the zone is an attractive place for the middle-size firm it is about to become. For all these reasons, enterprise zones can only succeed if they have something to offer to medium-size and larger firms as well as small businesses.

One of the strengths of the administration's proposal is that it contains important incentive provisions which may be generous enough to change the plant location decisions of profitable firms. However, the administration's proposed nonrefundable credits, even with the extended loss carry forward provisions of the proposal, are probably not sufficient to change the behavior of firms which are not likely to make significant profits in the near term. Among these would be small firms, many minority owned enterprises serving the distressed local economy, and most new enterprises. To offer future subsidies via tax credits against future earnings offers little assistance to these firms, which are usually critically short of working capital. At the current cost of capital for such an enterprise, the present value of a tax credit postponed for five years is about one-third of its face value. The present value of a dollar loss carried forward 10 years to a firm with a cost of capital in excess of 20 percent is less than 15 cents; and a 15 year carry forward offers the firm a present value benefit of only 5 cents. Clearly the loss carry forward component is valuable to those firms that can take advantage of the accumulated credits in the immediate future; for those new, small, and minority owned firms whose existence is typically nasty, brutish, and short, this component offers little assistance. Tax credits obviously help only those who pay taxes.

Past studies of what influences a company's decision concerning where to locate plants and jobs have concluded that most economic development incentives offered by states and localities have little influence on firms' decisions.[4] In many cases, part of the reason for these negative conlusions was the modest size of the incentives offered, in comparison to the firms' total costs of operation. Only when the enterprise zone legislation contains incentives of unprecendented generosity can any significant effect on employment in the zones even be hoped for. In the administration proposal only profitable enterprises receive extensive tax relief.

But firms will carefully weigh the benefits offered for operation within a zone against the potential costs and risks involved. After all, no amount of reduced tax burden on profits matters if plants cannot be built promptly, opened smoothly, and operated efficiently, so that profits can be made. Studies of what firms seek in deciding where to locate repeatedly identify the same factors as crucial in attracting firms to particular plant site. These factors include:

- The physical security of the plant site, including absence of threats to personnel, plant and equipment, and goods;
- Adequate space to construct a modern single-story plant and related storage and parking;
- Access to transportation modes, particularly railroads and highways; and
- Facilities within the site, including water and sewage hookups, local roads, and other infrastructure.

To medium and larger firms, these are key prerequisites to locating or expanding a plant; and they are precisely the sort of features readily available to these firms at many suburban and nonmetropolitan sites. However, they are definitely not the sort of features readily found in distressed inner-city residential and commercial neighborhoods such as would be designated as enterprise zones under the proposed legislation.

The administration's proposal suggests enterprise zones should not be located in heavily residential areas with little room for growth; however, many neighborhoods will have some modest room for growth without providing the type of location that firms seek for a new plant. While the administration's proposal does not expressly prohibit locations that would be competitive with suburban locations, the general guidelines regarding size (1-2 square miles) and neighborhood involvement suggest medium and large firms will not find enterprise zones particularly attractive sites for plant expansion.

Therein lies the potential Achilles' heel of the enterprise zone concept as presently envisioned: There would be little way to create a secure, decent-sized, industrially-prepared plant site for the sorts of firms which need to be attracted and yet remain within the designated zones, which are to be primarily residential and commercial.

Creating Inner City Industrial and Office Parks

Fortunately, with only one key modification, the basic enterprise zone approach can be rescued from this dilemma. This modification would be to allow the local separation of the job sites part of an enterprise zone from the residential sites. In particular, the job sites should be allowed to be clustered into large-scale, nonresidential in-city industrial and office parks. Such areas could compete effectively against suburban locations by offering the same sorts of security, space, and facilities as are available outside the city plus the financial incentives of the enterprise zone.

The reason that it is feasible to think of assembling large in-city acreage is, of course, that the inner cities of many major metropolitan areas are losing population at a rapid rate. Many vacant properties are coming into the possession of city governments through abandonment and default of taxes. Of course, the acquired properties are typically scattered in among other properties still in private hands. In some cases the process of large-scale land assembly therefore would require deliberate selection of certain neighborhoods for preservation and others for recycling, with the remaining occupants of redevelopment areas to be relocated over time. However, many cities already possess large vacant areas, resulting from past urban renewal projects; under the industrial park approach these vacant areas change from liabilities to valuable assets because they involve no additional displacement costs.

The process of selecting neighborhoods for recycling to alternative uses is never painless, and city governments would have to expect to face substantial political opposition. But the process of depopulation itself, with its concomitant reduction in the demand for housing, already has doomed many neighborhoods. Rational financially-strapped cities must concentrate their scarce housing and neighborhood revitalization resources on a small number of relatively strong neighborhoods, rather than scattering them thinly across the entire city.[5] The administration proposal recognizes this reality by requiring enhancement of zone neighborhoods at the expense of other areas by proposing better locally financed public services in the designated areas. Cities face the choice of either saving some neighborhoods--via a strategy of concentrating population into relatively stable neighborhoods and conversion of other neighborhoods into in-city industrial and office parks--or saving no neighborhoods; the more palatable third choice of saving all neighborhoods is simply not available.

The cityscape which emerges from this process, if it is successful, is a checkerboard of residential and industrial areas.[6] The land which is accumulated for industrial development must then be converted into industrial sites, and this conversion should be a priority use of cities' resources from such programs as HUD's Urban Development Action Grants. Infrastructure investments required for such a conversion must come from the public sector; the administrations "no appropriations" approach simply will not work. The claim that private interests will make such investments in exchange for tax credits is contradicted by the fundamental practices of corporate finance.

In this connection, it is useful to note a recent study conducted by us at the Urban Institute involving financial analysis of different forms of aid to industry. We found that offering developed plant sites is one of the most cost-effective ways for government to support private industry. Such aid is much more attractive to firms, per dollar of cost to the government, than, for example, worker training subsidies or local tax exemptions. This is because land is not a depreciable asset or expensable outlay, and therefore none of the benefits to the firms are offset by lower expenses or depreciation credits against the firm's federal corporate income tax liabilities.[7]

Linking the Industrial Parks to Poor Neighborhoods

The remaining difficulty with the approach proposed here is that there appears to be little guarrantee that the jobs created in these in-city industrial and office parks will be effectively linked to the employment needs of the residents of enterprise zone neighborhoods. This serious concern must be addressed.

It must be recognized that the administration's proposal does not attempt to specifically promote the employment opportunities of the disadvantages workers residing in the enterprise zone. There is a substantial tax credit for hiring disadvantaged workers irrespective of their place of residence. From one persepective, this is an appropriate orientation in that there is no reason to believe that a disadvantaged worker in an enterprise zone is more needy than a similarly situated person a few blocks away. There remains, however, the possibility that industrial and office parks sponsored under the urban enterprise zone program would not benefit disadvantaged workers because the job site is inaccessible to neighborhoods inhabited by the disadvantaged.

To assure that the disadvantaged workers can benefit from the proposed approach to enterprise zones, the physical assessibility of jobs to local and disadvantaged residents should be an important criterion in selecting industrial and office park sites. Facilitating this assessibility can be an important area for local action that could count as part of the required local contribution to a successful enterprise zone application. Local government could facilitate transportation links such as jitney bus services between neighborhoods with large numbers of disadvantaged persons and the industrial park. Special job recruitment and worker placement efforts also can be undertaken to link residents with the jobs. Through these mechanisms, the employers locating in enterprise zones are likely to have a much greater pool of disadvantaged worker applicants for jobs than they would if no special efforts were adopted.

Conclusions and Recommendations

In conclusion, let us summarize the approach we are advocating in terms of two recommendations:

- First, the proposed enterprise zone legislation should be revised to permit the separation of plant sites from residential areas in enterprise zones and the development of those plant sites within large, suburban-like industrial parks.

- Second, at the state and local level, officials should be prepared to implement the strategy for recycling urban land. This means selecting some inner-city areas which are to be preserved as residential neighborhoods and other areas to be converted to industrial use; reserving residential development resources exclusively for the residential areas to be preserved; and targeting substantial UDAG and other resources to infrastructure development in industrial parks at the other locations.

The political costs of implementing such a strategy are not small. And the urban development process envisioned is far slower and more costly than is envisioned for enterprise zone approaches not involving such infrastructure investment. But the problems of the declining economic base and population of large inner cities are so serious and so intractible that no lesser measures are likely to succeed.

FOOTNOTES

1. David Birch, "The Job Generation Process," in U.S. 96th Congress, Joint Economic Committee, The Effective Utilization of Small Businesses to Promote Economic Growth. GPO: Washington, D.C. October 25, 1979.

2. Catherine Armingont and Marjorie Odle, "Sources of Recent Employment Growth: 1978-1980," Mimeo. Business Microdata Project, The Brookings Institution.

3. For substantiation of these assertions, see Harvey A. Garn and Larry C. Ledebur, The Role of Small Business Enterprise in Economic Development (Joint Economic Committee, U.S. Congress, 97th Congress, 1st Session, 1981).

4. See, for example, Roger W. Schmenner, The Location Decision of Large, Multiplant Companies: A Summary (Washington: U.S. Department of Housing and Urban Development, 1981).

5. For a strategy of selective neighborhood preservation in one large distressed city, see David W. Rasmussen and Raymond J. Struyk, A Housing Strategy for the City of Detroit (Washington: The Urban Institute, 1981).

6. For a general discussion of urban land banking approaches such as we are proposing, see Wilbur Thompson, "Land Management Strategies for Central City Depopulation," in How Cities Can Grow Old Gracefully (Subcommittee on the City of the Committee on Banking, Housing, and Urban Affairs, U.S. House of Representatives, 95th Congress, 1st Session, December 1977).

7. See David W. Rasmussen, Marc Bendick, Jr., and Larry C. Ledebur, "Evaluating State Economic Development Incentives From A Firm's Perspective," Business Economics, forthcoming 1982.

Chamber of Commerce of the United States of America
Washington

STATEMENT
on
THE ENTERPRISE ZONE TAX ACT OF 1982 (S. 2298)
for submission to the
SUBCOMMITTEE ON SAVINGS, PENSIONS
AND INVESTMENT POLICY
of the
SENATE COMMITTEE ON FINANCE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
David E. Franasiak and William D. Kelleher

May 5, 1982

STATEMENT
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THE ENTERPRISE ZONE TAX ACT OF 1982 (S. 2298)
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SUBCOMMITTEE ON SAVINGS, PENSIONS
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David E. Franasiak* and William D. Kelleher**
May 5, 1982

The Chamber of Commerce of the United States is the largest federation of business and professional organizations in the world, and is the principal spokesman for the American business community. The Chamber represents more than 240,000 members, of which more than 235,000 are business firms, more than 2,800 are state and local chambers of commerce, and more than 1,300 are trade and professional associations.

More than 85 percent of the Chamber's members are small business firms having fewer than 100 employees, yet virtually all of the nation's largest industrial and business concerns are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at-large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber also represents a wide management spectrum by type of business and location. Major classifications of American business—manufacturing, retailing, services, construction, wholesaling, and finance—all have more than 15,000 business represented as members of the Chamber. Yet no one group represents as much as 23 percent of the total Chamber membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber supports the concept of enterprise zones and supports S. 2298. While the Chamber does not favor geographically targeted tax incentives, it recognizes the need to provide jobs in our deteriorating communities.

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* Director, Tax Policy Center, Chamber of Commerce of the United States

** Director, Community Development, Chamber of Commerce of the United States.

Enterprise zones are based on the concept that decaying communities can best be helped by creating a free market environment favorable to growth. Instead of simply handing out subsidies, enterprise zones will create the impetus for local and state governments to remove obstacles to private initiative created by excessive taxes and regulations. More and more analysts are coming to realize that it is the absence of new private sector activity or expansion of existing activities that causes areas to decline, not the loss of old activities, since business failures occur in all parts of the country. In the past, too much government policy has focused on trying to save obsolete activities instead of creating an environment to encourage growth.

The enterprise zone experiment as outlined in S. 2298 is an important first step in reversing the outdated subsidy approach to local economic development.

CONCEPT

The concept of enterprise zones is based on the belief that even in the most depressed neighborhoods and small towns there is economic potential. Further, this potential is being blocked by high marginal tax rates that deny entrepreneurs of the rewards needed to compensate for the higher risks of operating in a depressed area and by excessive regulation that suffocates initiative. Further, the concept assumes that the creation and expansion of small business will lead these areas to recovery. Studies have shown that small business accounts for up to 80% of the new jobs created in our country and adds to the productive capacity of the nation. Moreover, they tend to be owner-operated. As in owner-occupied housing, the presence of the owner adds to neighborhood stability and improved community relations.

S. 2298 authorizes the Secretary of Housing and Urban Development (HUD) to designate up to 75 areas at the rate of 25 areas per year for a three year period. Enterprise zones nominated jointly by city and state governments would be eligible for federal, state and local tax and regulatory relief. Each state and local government would propose its own set of relief and service improvement measures. The federal incentives include:

o additional 3 or 5 percent investment tax credits for purchases of equipment used in a zone and 10 percent for construction or rehabilitation of structures;

- a 10 percent credit to employers for payroll paid to zone employees in excess of payroll paid the year before the zone was designated, up to $1500 per worker, and an expanded tax credit for hiring disadvantaged workers;
- elimination of capital gains taxes for qualified property;
- continued availability of industrial development bonds to small firms, even if they are eliminted elsewhere;
- extended carryovers for net operating losses and tax credits incurred in the zone; and
- designation of zones as foreign trade zones allowing relief from tariffs for re-exported items.

GOVERNMENT ROLE IN COMMUNITY ECONOMIC DEVELOPMENT

As David Birch of the MIT Program on Neighborhood and Regional Change has pointed out, government economic development strategies aimed at holding onto old firms and obsolete functions do not work. In fact, the rates of job loss and business failure seem to be similar in all parts of the country. It is the rate of new job creation that varies.

Traditionally, government programs have focused on holding on to jobs and working with a few large companies or developers. This mode of operation is easier for government because large firms are easily identified and the risks and rewards of direct assistance can be readily calculated. Politically, those supporting this type of program can point to immediate success when the program works.

Aid to emerging small businesses is much more difficult. First, small businesses fail frequently and agencies trusted with the care of public funds cannot easily justify the loss of the moneys conveyed to them. Second, for the most part, small business does not want or use direct aid. When polled at last year's White House Conference on Small Business, the overwhelming majority of participants asked that tax laws be reformed to permit small business to gain and retain capital more easily. In the top sixty recommendations of the Conference, there was not one suggestion for direct economic assistance such as loan guarantees, interest subsidies or grants. The basic thrust of the recommendations was that the less government agencies become involved in these affairs, the more small business people would like it.

The mission of government is to create an attractive climate for business formation. The Chamber believes three major government actions are needed in this regard:

- Regulatory relief to cut the delays, costs and inefficiencies caused by government red tape at every level of government.
- Tax relief to allow more funds to remain in private hands.
- Rebuilding our basic infrastructure of roads, sewers, water supply systems, waste disposal facilities and bridges.

Regulatory and tax relief are needed in all aspects of our economy. The Reagan Economic Recovery Program has provided the basic direction in these areas, and we urge Congress to stick with the program it adopted last year. However, it is infrastructure repair and restoration that is most important for enterprise zones to succeed. Such repair and restoration is an activity where state and local government can play a key role.

As Pat Choate and Susan Walter point out in their study of the current decay in our public works system, America in Ruins:

> Public works play a crucial role in the creation of national wealth and productivity growth. Education, research and development and public works are the only real supply side investments and public sector makes in our economy.

Economic development is dependent upon a sound public infrastructure, yet, our cities and other declining communities have neglected this area to their economic detriment. Despite widespread evidence of decay, the nation's annual investment in public works has actually declined by over twenty percent from the 1965 level. In certain select functions, such as highgway and street construction which could have a major impact on an enterprise zone, investment has declined by 50 percent in 1972 dollars.

If enterprise zones play no other fuction than to re-focus government on the need to provide basic public services, they will be a success.

Because the provision of basic public works and services are the responsibility of state and local government, successful enterprise zones will be those that reflect local initiative, creativity and support. Zones created simply to chase after federal aid in the traditional grantsmanship game are destined for failure. The ultimate responsibility for revitalizing individual decayed communities rests at the state and local level.

In addition, state and local government can play a major role in the deregulation effort connected to enterprise zones by removing barriers to development caused by excessive regulatory burdens connected to zoning and building codes, various permit requirements, and redundant central planning approvals.

PUBLIC-PRIVATE PARTNERSHIP

Cooperation between the public and private sectors will also be important to the success of an enterprise zone. The unmet needs within a zone will be too massive for any single organization to meet. The need for cooperation or partnership reaching down to the neighborhood level is a factor in implementing a successful enterprise zone. The partners who join together to restore a community may find it necessary to develop a multifaceted outline for action or a plan that will bring together those elements needed to create a positive business and neighborhood environment. This partnership should be voluntary and each partner should confine itself to its own area of expertise and field of action. The mistake of past revitalization efforts has been the use of government programs and funds to replace private activity, especially where private action has not come forth as anticipated. True partnership cannot be based solely on governmentally subsidized activity.

GEOGRAPHICALLY BOUNDED TAX INCENTIVES

Although we support the enterprise zone concept, we would prefer avoidance of geographically bounded tax incentives. Such incentives are, on their face, inherently inequitable and discriminatory, and should be utilized as a last resort on a limited basis. Any tax incentives must be carefully drawn to minimize windfall and perverse effects. Congress should examine the impact of the newly enacted Accelerated Cost Recovery System and provisions relating to building rehabilitation.

DANGERS TO ZONE CONCEPT

There are two major dangers to the enterprise zone experiment. First, as the legislation establishing this experiment moves through Congress, there will be more and more effort to add new incentives or new requirements for zone participation or designation. If the enterprise zone process becomes too complex, it will defeat the very purpose of the experiment. The purpose of enterprise zones is to remove the complex maze of taxes and regulations that is stifling the free enterprise system. Removing one set of bureaucratic rules and obstacles and replacing them with another is not progress.

Second, successful enterprise zones cannot be punched out cookie-cutter style predicated on Washington-based economic development theory. Many groups are already proposing to add traditional Washington-oriented subsidy programs to the zone. This approach is rejected by the Chamber and particularly by its small business members. Business wants less Washington interference and direction. Enterprise zones that are weighted down with excessive non-economic development programs will hinder business development and reduce the private sector's ability to fight poverty and create jobs through the free enterprise system.

SUMMARY

To help revitalize decaying or abandoned urban areas and to stimulate increased economic activity and employment opportunities in such places, the Chamber supports federal legislative proposals to establish enterprise zones that will use the rewards and incentives of the free enterprise system rather than subsidies to restore our cities and their older neighborhoods. Such legislation should be based on the following principles:

1. The number of areas designated as enterprise zones should be limited to a small number and be carefully monitored over time.
2. Geographically bounded tax incentives are inherently inequitable and discriminatory and, therefore, inconsistent with sound federal tax policy. If enactment of enterprise zone legislation incorporating geographically targeted tax incentives cannot be avoided due to social, political and economic reasons, the Chamber is prepared to help shape the tax incentives provisions to minimize administrative complexity and to reduce the potential for tax compliance issues.
3. Congress should first examine the impact of tax credits and incentives for the rehabilitation of older buildings and investment in plant and equipment provided in the Economic Recovery Tax Act of 1981 before enacting new special tax provisions for development in enterprise zones.

4. Any employment or employment training provisions imposed on enterprise zone employers for the hiring of the disadvantaged should be based on incentives rather than restrictions. Overly restrictive or counterproductive requirements for the hiring or training of the disadvantaged or the population native to the zone area, such as mandating that employers hire 40% of their staff from among the CETA-eligible population, should be avoided.
5. Emphasis should be placed on removing the barriers to economic growth imposed by various federal, state and local regulations such as zoning and various land use controls.
6. The rehabilitation or upgrading of basic public services should be the major contribution of government to the zone. Examples of actions in this area include highway and street repairs and provisions for adequate waste disposal systems.
7. No new special federal subsidy programs should be provided to encourage the development of enterprise zones. Nor should businesses locating in the zone be given special preference for existing federal programs.
8. The revitalization of specific urban places or neighborhoods is primarily the responsibility of state and local government. The federal government's most important contribution to this effort is ensuring national economic growth.

THE CITY OF NEW YORK
STATEMENT FOR THE RECORD BY DEPUTY MAYOR KAREN N. GERARD BEFORE THE SENATE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

"The Enterprise Zone Tax Act of 1982"

STATEMENT FOR THE RECORD

The City of New York is pleased to take this opportunity to comment on the proposed "Enterprise Zone Tax Act of 1982" introduced by Senator Chafee and Representative Conable and on the Reagan Administration's Enterprise Zone Proposal. The Administration's proposal, released in March, is linked to the "Enterprise Zone Tax Act of 1982" and provides an indication of how the Administration would interpret the legislation.

New York City has consistently endorsed the concept of Enterprise Zones - providing Federal tax incentives to stimulate job growth and retention of businesses in economically distressed areas. We are pleased that an Administration proposal and a bill have been submitted that can form the basis for discussion and legislative action. However, we wish to present some general reservations concerning the Administration proposals, as well as comment on specific features.

Most important, tax measures alone cannot attract increased business investment to these areas when vital support programs are cutback, including CETA, UDAG, EDA, Federal Crime Insurance, Federally guaranteed loans, and Industrial Development Bonds. The Administration's reliance on tax incentives as an antidote for the Nation's economy has not yet had the promised effect; yet this same tax relief emphasis is expected to be the cornerstone for the success of an Enterprise Zone.

New York City has had to bear a $460 million reduction in the 1982 Federal budget and would lose over $700 million in 1983 as a result of 1982 and proposed 1983 Federal cutbacks. In contrast, the estimated Federal revenue losses associated with one Enterprise Zone have been estimated at $12.4 million annually. Clearly an Enterprise Zone can not effectively substitute for other Federal economic programs.

The City is also concerned that the Administration's proposal emphasizes tax relief, privatization and deregulation at local levels, shifting the focus of local effort from the more traditional economic development areas that New York City has specifically endorsed such as job training, security and capital availability programs. Furthermore, the City will be given "little or no credit" for existing economic development programs that apply "relatively uniformly" State or community wide. This provision suggests that many of the City's current economic development programs may be of little value in the competitive Enterprise Zone selection process, giving an advantage to jurisdictions that previously had not implemented development programs. New York City and State have a vast number of existing programs providing loans, security, business services, employment training, infrastructure repair, and tax incentives and abatements. We urge that State and local programs such as these be credited.

With regard to specific Enterprise Zone tax incentives, the proposed Bill provides little for locally-based small businesses such as existing firms, expanding firms and start-up or marginal firms with little or no tax liabilities. Instead, the proposal provides the strongest tax incentive for larger firms with extensive tax liabilities that have the capital to invest and expand in the Enterprise Zone. The City believes that locally-based firms hold significant promise for job generation in distressed areas and should receive benefits commensurate with those received by wealthier firms.

In addition to the items already discussed, the following comments represent concerns the City has with specific provisions of both the "Enterprise Zone Tax Act of 1982" and the Administration's Enterprise Zone Proposal.

Number and size of zone. According to the Administration proposal, "degree of poverty and fiscal distress" of the applying community is merely mentioned in the category of "other factors to be included" in the Federal selection process. Yet a large, fiscally-pressed city like New York contains a number of distressed areas. The City is concerned that the size and number of zones to be designated by the Federal government reflect the level of need of the locality. Another major concern is that proximately located underutilized industrial sites that can not meet the various population or poverty eligibility criteria be permitted within the Enterprise Zones.

Legislation in place prior to Federal selection. The Enterprise Zone Bill mandates that State and local legislation be in place prior to Federal selection, requiring the City to commit to an Enterprise Zone without any guarantee of eventual Federal zone designation. This element may be a problem if the City incurs additional costs as part of "local effort" and then does not reap the additional Federal incentives that are needed to make the concept work. Some mechanism should be available whereby a municipality can determine if its package of local incentives would meet Federal standards before local legislation is enacted.

State role in local zone designation. The Bill mandates that both State and local governments pass nominating legislation creating Enterprise Zones and zone incentives. This procedure gives the State legislature "veto" power over the locality's efforts at forming a zone. The City maintains its previous position that State governments should not be given such absolute veto rights with respect to Enterprise Zones. For example, a proposed New York State bill limits to six the number of State zones to be created. Such a restriction, if passed, could limit the City's flexibility to have two or more zones.

Disadvantages for small, marginal, or start-up business without significant tax liabilities. Because the employer and employee tax credits are non-refundable, businesses without major tax liabilities receive negligible benefits in the initial years of the program. (The City supports the notion of refundable tax credits which were provided in the Kemp-Garcia legislation as an attempt to assist the needs of these firms.) The presence of the 24-year operating loss carryover will partially compensate for this problem, but may not provide payoffs for the start-up firms for a number of years. The proposal as written would provide far greater incentives for large successful corporations choosing to expand operations in Enterprise Zones.

Another approach to this problem of negligible benefits to firms without tax liabilities would be to grant zone firms the option of selling their unused investment tax credits. This could be done in a number of ways including safe-harbor leasing under the Federal Economic Recovery Tax Act.

Lack of benefits for existing, non-expanding firms. The capital gains elimination is the only tax incentive that is fully applicable to existing, non-expanding businesses. The employer tax credits and the investment tax credit apply only to additional activities or hires after the zone designation. The Administration's proposal does little to encourage retention of existing marginal businesses within Enterprise Zones.

Capital availability. The proposal does not address the problem of obtaining affordable capital for small, start-up businesses. The Kemp-Garcia provision which partially sheltered interest income from bank loans made to zone businesses is regrettably absent in the Administration's proposal. The elimination of capital gains taxation and the investment tax credit assist only those firms that have sufficient resources to make the initial investment. The capital availability problem could be partially addressed by an "expensing provision" which would shelter the income of private investor's (not banks) making small loans to firms. This concept has recently been introduced in British Enterprise Zones. The expensing provision should be further evaluated to determine its application to U.S. Enterprise Zones.

Employment training. There are no direct provisions for employment training. Instead, the proposal maintains that employer tax credits for disadvantaged employees will encourage employers to "establish basic job training programs to improve the productivity of these workers and make them more employable". Since job training is such a crucial component in an Enterprise Zone, a more powerful, direct training incentive should be provided by this legislation. Represenitives Kemp and Garcia recently introduced legislation to reauthorize Title VII of CETA which funds the Private Industry Councils (PICs). This effort to link job training to Enterprise Zone residents represents the kind of Federal effort the City believes should be included in Enterprise Zone legislation.

Disadvantaged worker definition. The Administration's definition of an employee that would qualify a business for a tax credit is more restrictive than the Kemp-Garcia legislation. The new language limits this pool of employees to welfare recipients, vocational rehabilitation referrals, foster children and handicapped individuals, and excludes the marginally poor. Furthermore, firms would be unlikely to hire these individuals unless there were a strong training program. Such a component is notably absent from the Reagan proposal. The current CETA eligibility requirement for Title IIB would be an alternative "disadvantaged" definition that the City could support.

Unacceptable implications regarding zone rescinding and "guaranteed" local effort. The Administration's bill reserves the right for HUD to "rescind" Federal tax benefits if localities do not come through as promised with local incentives. A procedure is also suggested whereby a business or resident can sue the local government for enforcement of a promised "local effort" plan and for reimbursement for damages. These provisions could create serious legal and financial difficulties for both business and the City.

FMI
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April 30, 1982

The Honorable John H. Chafee
Chairman, Subcommittee on Savings,
Pensions and Investment Policy
Committee on Finance
United States Senate
Dirkson Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

I am pleased to have this opportunity to submit the views of the Food Marketing Institute on the administration proposal on enterprise zones (S. 2298).

The Food Marketing Institute (FMI) is a non-profit association that conducts programs in research, education and public affairs on behalf of its 1100 members -- food wholesalers, retailers and their customers in the United States and overseas. FMI's domestic member companies operate over 17,000 retail food stores with a combined annual sales volume of $120 billion -- half of all grocery sales in the United States. More than three-fourths of FMI's membership is comprised of independent supermarket operators or small regional firms. Many of our member firms are located in economically distressed areas in inner cities and rural towns, the areas to which the enterprise zone proposal is addressed.

The Food Marketing Institute supports and approves the enterprise zone concept and the objectives which it seeks to accomplish. Many of our member companies are acutely aware of the many problems involved in inner cities and economically distressed rural areas. We strongly favor the idea of creating free market environments in depressed areas through the removal of government burdens -- relief from taxes, regulations and other types of government burdens.

As we understand the administration bill, no distinction will be made as between particular types of businesses within the enterprise zones insofar as eligibility is concerned. We applaud the statement made to your subcommittee by the Honorable John Chapoton, Assistant Secretary of the Treasury that "the intent is not to foster a particular kind of business activity. The federal tax features of the program therefore contain strong incentives for labor-intensive business ..."

FMI could not support any program which would apply, for example, only to manufacturing enterprises and which would, therefore, discriminate against retail enterprises. Thus, we support the administration proposal before you, since it applies equally to all types of business activity. We urge, in addition, that any bill reported by your subcommittee be made as simple as possible under the circumstances, since one principle thrust of the enterprise zone concept is to relieve business from burdensome requirements. Finally, we particularly want to express our support for the federal tax incentives contained in the bill, and the aspects which are also designed to provide relief from state and local taxes.

We appreciate this opportunity to present our views on this important matter, and request that this letter be made a part of your hearing record.

Sincerely,

Harry Sullivan
Senior Vice President
and General Counsel

HS:gam

METROPOLITAN HOUSING AND PLANNING COUNCIL
Testimony Submitted to
Senate Finance Committee
April 23, 1982

Enterprise zones can succeed only if part of a comprehensive urban policy. By definition, enterprise zones are intended to address discrete small scale urban pockets, not wholesale rejuvenation of cities. By admission, enterprise zones are an experiment to test and demonstrate the effect of unfettered free-market innovations. Today, that comprehensive urban policy is not articulated by any level of government.

The proposed Federal Enterprise Zone Act properly shifts the focus of government programs aimed at distressed urban areas to the economic base of the city. This shift need not be at the expense of meeting housing and other urban needs but rather offers necessary ingredients to give people access to housing and services in an economically strengthened neighborhood.

There will be no magic in enterprise zones. They will work only if carefully planned at the local level, if all the essential program ingredients are included and if there are community strengths and leadership on which to build. Enterprise zones involve careful choices in order to provide economic incentives for businesses, both large and small, and economic opportunity for city residents, particularly those now unemployed in the zone, both without undermining the fiscal integrity of federal, state and local governments. Enterprise zones must forge a creative partnership between business, labor, government and the community to create the conditions ripe for the development and enhancement of the urban economic base.

The successful innovations that emerge from the enterprise zone experiment can be adapted and adopted in other places and on a larger scale. Imaginatively designed, enterprise zones can provide a testing ground for innovations in areas like regulatory relief, incubator space, capital formation for new small businesses and cooperative ventures by business, government and community to provide local public services. The competitive nature of the designation process at all levels of government will no doubt and regrettably lead to the inclusion in all applications of costly and not always appropriate program elements, in particular, property tax breaks and massive infrastructure investments. This kind of action, especially by financially strapped local governments, could lead to a political backlash should its consequence be a revenue loss only able to be made up by increased taxes or reduced services in those parts of a community not within an enterprise zone.

The Council has identified in the course of its study of the enterprise zone concept certain priorities to be weighed in determining preferences for zone designation:

-- First, zones should be of a scale and composition to make them success oriented. They should be small enough to focus services and incentives and to measure results.

-- Second, zones should be eligible for and be a target of all existing government programs and technical assistance. We must use the resources now in place in a more effective and creative manner before expanding the repertoire.

-- Third, zones should address the needs of small and minority businesses at the least cost to government. Not tax breaks but capital formation should have priority. Small business development today produces the overwhelming majority of America's new jobs.

-- Fourth, the expected institution of a federal enterprise zone program and the burgeoning of companion state and local models requires attention to the administration of the program by all levels of government. Proposals to date tend to give their attention to incentives and designation, not to practice and evaluation.

Enterprise zones are not a comprehensive urban policy but could be a valuable part of one. Enterprise zones bet that inner city areas are a sound investment given the right combination of economic incentives and business, labor, government and community participation. The Council supports that bet. We urge concentration on a few carefully developed and meticulously evaluated demonstrations instead of a proliferation of free-fire zones, some of which may succeed by chance. The federal legislation should enumerate the elements listed above as warranting priority in zone designation; yet critically, no one particular incentive, least of all tax breaks, should be even implicitly held out as a threshold requirement. Each prospective enterprise zone must be judged on its potential for success and on the care given to developing a program precisely targetted to the needs and possibilities of the proposed zone.

The Metropolitan and Housing Planning Council is a 48-year old civic group long involved with comprehensive planning issues in the Chicago metropolitan area. Our consideration of the enterprise zone concept has led to the Council's participation on the Governor's Task Force for Illinois Enterprise Zone Legislation.

STATEMENT OF MAYOR WILLIAM T. McLAUGHLIN
WILMINGTON, DELAWARE
REGARDING THE ENTERPRISE ZONE TAX ACT OF 1982
TO THE SENATE FINANCE COMMITTEE
MONDAY, MAY 24, 1982
WASHINGTON, D.C.

President Reagan's Enterprise Zone Proposal offers a broad and complex series of incentives to invest in distressed urban areas. The reduction of taxes and regulatory burdens in enterprise zones could do a great deal to encourage new business and expand job opportunities in neighborhoods within easy reach of unemployed people. I endorse the underlying objective of enterprise zones, and I strongly urge that the concept be given the best possible opportunity to demonstrate that it can offer new ways to strengthen urban economics.

Since two-thirds of the nation's new jobs are generated by small firms, small business formation is essential to the success of the enterprise zone. Yet, I am concerned that the proposal in its present form does not offer sufficient encouragement for small business development. I believe stronger incentives are needed to compensate financial institutions and individuals for the added risks and cost of providing venture capital and low interest loans to firms locating in the zones. I also believe that the proposed tax credits will not do enough to help small firms and new businesses with no tax liability.

As I am sure you are aware, a number of studies have shown that high interest rates and the resulting high cost of capital poses a far more serious barrier to firm formation or expansion than the tax or regulatory environment. A study recently conducted by the City of Wilmington reached a similar conclusion. We interviewed the chief executives of 76 New Castle County firms to determine what taxes and regulations might be modified to stimulate new business activity. Firms listing more than five, but less than 100, employees were selected at random in the areas of construction, manufacturing, transportation, and wholesale trade. A copy of the project report is attached, but in summary the most important findings were as follows:

1. Few objections were raised about specific regulations, but concerns were repeatedly expressed about the nature of the process (too cumbersome, unnecessarily complex, conflicting, and too many permitting and licensing jurisdictions).

2. Aside from the general complaint of tax burdens being too high, the majority of the respondents expressed no particular complaint about the present tax structure.

3. While a streamlined regulatory process and reductions in the tax bill might provide the marginal break necessary for the profitability of a small firm, the lack of low cost capital poses a far more serious problem for a firm wanting to begin or expand business.

A number of ways have been proposed to spur small business growth in enterprise zones. For example, a consultant study for the U. S. Commerce Department's Minority Business Development Agency suggested a tax credit for equity investment and permission to write off such investment in the first year (see Task Force Report on The Impact of Enterprise Zone on Small and Minority Business). Senator John C. Danforth proposed a similar provision in his rural enterprise zone bill. A computer analysis by the accounting firm of Coopers and Lybrand found that most enterprise zone proposals would provide little incentive for a hypothetical middle-size firm. The exception was Senator Danforth's proposal which, it was determined, would help increase the firm's profits substantially.

Another approach is to allow enterprise zone firms to issue Small Business Participating Debentures (SBPD), a financing instrument proposed in S. 360, the Omnibus Small Business Capital Formation Act, and to allow the debt instrument to be treated as an immediate ordinary loss. Mr. Paul Pryde, Jr., of Janus Associates, a Washington based consulting firm, suggests that this proposal "would constitute a powerful inducement to increase investment in enterprise zone firms" (see "The Use of Tax Incentives to Stimulate Business Expansion in Enterprise Zones", statement of Paul L. Pryde, Jr., President, Janus Associates, before the Senate Small Business Committee, February 25, 1982).

Many commentators have also pointed out that small firms will derive very little benefit from the nonrefundable credits proposed in the Administration's Enterprise Zone Bill. As we know, smaller firms generally have very little taxable income in their early years. Thus, any tax credit and accelerated depreciation deductions to which they are entitled are likely to go unutilized. Nonrefundable tax credits would have no immediate impact on small businesses that are just starting up and operating at the margins. In order to avoid penalizing small firms that invest in an enterprise zone but do not pay enough taxes, I believe that the provision for partial refundability of taxes contained in the 1981 version of the Kemp-Garcia-Chafee-Boschwitz Bill should be reinstituted.

I believe that an enterprise zone with meaningful incentives for small businesses can play an important role in stimulating economic development in distressed urban neighborhoods. The program would be an excellent supplement to the front-end funding capital incentives provided for in the EDA and UDAG Programs. I urge this committee to look carefully at alternative ways to increase access to the capital markets by small firms locating in enterprise zones. I would also propose that the Enterprise Zone Act be structured to supplement existing successful urban incentives (UDAG, EDA, and SBA) to provide cities with a competitive and comprehensive framework with which to attract job intensive and capital intensive industries.

ds
Attachment

MEMORANDUM

TO: Tim Barnekov
Department of Commerce

FROM: Steven [illegible]ffman
Project Consultant

RE: The Enterprise Zone Legislation - The Business Community's Response; Survey Results

DATE: April 23, 1982

Most of the debate concerning the viability of the enterprise zone legislation has taken place in the absence of information from those who will determine success or failure, namely, the business community. To correct this deficiency, a survey of the New Castle County business community was conducted. This memorandum: 1) describes the methodology utilized in the survey, 2) summarizes the responses derived from the survey, and 3) comments on the power of regulatory change and tax relief.

METHODOLOGY

The methodology utilized in the survey proceeds from certain basic assumptions found in the proposed legislation.

1. Certain sorts of firms are likely to provide the bulk of economic activity to be encouraged within the zones. This includes smaller firms (which coincidentally provide the major source of new employment in the economy), firms not tied to a retail market, and firms that can either utilize existing infrastructure or can generate the capital necessary to modify the existing stock.

2. Labor intensive activity is also encouraged in the legislation. This is particularly true in the Administration's most recent proposal which removes accelerated depreciation provisions and incorporates substantial credit to firms hiring disadvantaged workers. Here again, small firms not needing substantial capitalization are prime targets.

These assumptions were utilized in constructing this sample. The following restrictions applied to the possible universe:

1. SIC activities under the construction, manufacturing, transportation, and wholesale categories were selected. Only classifications with more than five firms were selected in order that wholly unique situations were not taken to represent more general circumstances.

2. Firms with more than five, but less than 100 employees, were selected. Precise estimates of employees were not possible due to the data set from which the sample was drawn (Delaware Directory of Commerce and Industry, 1981-1982).

3. Firms in the Wilmington, New Castle, and Newark geographic areas were selected. This represents the overwhelming majority of all firms in the County. The universe was 329 with the sample being 76.

The firms actually surveyed were selected at random from the classifications. No attempt was made to construct a true scientific sample and, therefore, no estimate of sample error is possible. Given the nature of the universe, however, it is unlikely that a truly random sample would yield results far different from those discussed in this memorandum. Appendix 1 is a sample survey instrument. It should be noted that the nature of the survey made a good deal of probing and follow-up questioning necessary. The instrument should, therefore, not be taken to represent the total breadth of the interview. The length of time for each interview varied from between 10 to 30 minutes.

While the survey was primarily interested in gaining knowledge about specific taxes and regulations, questions were also asked concerning the likelihood of the suggested changes actually stimulating the desired behavior. The questions were not, however, structured so as to pose the possibility of relocation since this is a practice that would produce no net benefit for the local economy and should, therefore, be discouraged in the legislation. Finally, the survey sought to gauge the degree of importance that regulations play with respect to other factors present in the current economic and financial environment.

FINDINGS OF THE SURVEY

Analysis of the respondent population was conducted by both size of firm and by SIC classification. With regard to the size of the firm, there were no significant differences existing across the size classes. The relatively small number of larger size firms, i.e., 26 to 100 employees, should, however, be a cause for caution in generalizing across all firms. Some differences do, however, exist when SIC classifications are analyzed. The difference lies not so much in the nature of the responses, but in the intensity of the responses. In fact, while the sample sizes were roughly similar for SIC codes 01 (construction) and 05 (wholesaling) only 10 (37%) of the respondents in the 05 group mentioned objectionable regulatory practices, while 15 (63%) of the respondents in the 01 group expressed difficulties in dealing with the regulatory environment.

Appendix 2 details the responses found with respect to the present regulatory environment. Perhaps the most consistent objection expressed was the regulatory process itself, particularly at the local level. Concerns were repeatedly voiced about the nature of the process, being variously described as cumbersome, unnecessarily intricate, complex, and serving as an extreme hindrance to economic activity. Concern was also expressed about the multitude of permitting and licensing jurisdictions and the often time conflicting nature of the regulations, a problem requiring the joint actions of the area's jurisdictions. Few objections were raised, however, about the regulations themselves. Only in a very few instances did respondents identify specific local or state regulations which could be modified so as to influence economic activity. The only frequently noted objection concerned the payment of Workmen's Compensation and Unemployment Insurance, a number of respondents feeling that small to medium-sized firms are being made to subsidize the inefficiencies of larger firms.

Problems with taxes were also not overwhelming, aside from the general complaint of tax burdens being too high. The majority of the respondents expressed no particular complaint about the present tax structure. In fact, a number stated that the present structure is fair and provides a hospitable business climate for the state. Specific comments included:

1. Repeal of the Mercantile Tax.
2. Rescheduling of the Payroll Tax such that payment is required quarterly instead of the present every 15 days.
3. Elimination of the Gross Receipts Tax in favor of a more general sales tax.
4. Elimination or modification of the City's wage tax.

In no case did one respondent mention more than one of the above suggestions. Again, the responses did not vary across from size and in the case of taxes, response did not vary by SIC code. (See Appendix 3.)

CHANGES AS AN INDUCEMENT FACTOR

The power of the changes suggested above to induce either locational change (a suggestion which was avoided in the survey) or to encourage new activity was decidedly mixed. A number of the respondents expressly stated that in no circumstance would they consider moving into Wilmington, or, would they consider starting a firm in the City. Again, there was no prompting from the interviewer regarding movement into the City. A high percentage of the respondents said that the regulatory or tax differentials would make no difference in their locational decision. Of those that said changes might influence location, all were in agreement that such changes would have to significantly reduce the cost of doing business before the changes would act as an inducement. Given the small contribution that local taxes make to the total tax bill, it is unlikely that the changes in the local tax code could produce significant reductions. It should be pointed out, however, that to the new small firm with limited capital, a small change in the tax bill might, in fact, provide the marginal break necessary for profitability. A streamlined regulatory process might act as an inducement, since time itself is a scarce resource to the small business person.

The survey also posed the question of the relative significance of the regulatory environment in a more general fashion (see question #4, Appendix 1). Here there was substantial consensus. The regulatory and tax environment runs a distant second to the lack of low-cost capital as a barrier to new economic activity. High interest rates and the resulting high cost of debt capital poses the more serious problem for a firm wanting to expand or to begin business. Until interest rates are modified or low-cost financing is made available, it is unlikely that regulatory and tax changes will spur much activity in the designated areas.

SH/jem

Appendix 1

Name of Firm ____

# of Employees ____

person contacted/position ____

SIC Code ____

Telephone Number ____

tme/date/length of Interview ____________________________

INTRODUCTION

I am (name) from the Wilmington Economic Development Corporation. I am calling to seek your advice about the Enterprise Zone Proposal. (explain if necessary.) We are surveying certain firms in the (area) business community to get their advice about which regulations and taxes might be changed or eliminated as a way of encouraging firms to locate in certain areas of cities. The information will be confidential. If you care, I can read you the questions and call you back either later today or tommorrow to get your responses. We will need about 10-15 minutes to complete the survey.

Question #1.

If you were considering expanding your business, or starting a new firm, what federal, state, or local regulations that affect your business would you modify, change, or eliminate as a way of encouraging you to expand/start the business?

FOLLOWUP--what regulations have caused you problems recently?

--do you know of any instances in the last couple of years where certain regulations have caused someone to close up or where unnecessary costs have benn imposed upon them?

Question #2.

If you were considering expanding your business, or starting a new firm, what federal, state, or local taxes would you modify change, or eliminate as a way of encouraging you to expand/start the business?

FOLLOWUP--same as Question #1.

Question #3.

Let me pose a hypothetical question. If these changes were made in one part of the County and not another, would it change your mind about where to locate?

Question #4.

In today's business and financial environment, what is the biggest obstacle preventing you from expanding your business? If you were starting a new firm, what owuld be the biggest obstacle from starting that business?

--availability of low-cost capital ____
--government regulation ___
--taxes ___
--other (note) ___

APPENDIX 2

Responses by SIC Code (Regulations)

01 Construction

N = 24

Complexity of Process (12)
Competing Jurisdictions (3)
Workman's Compensation (3)
Minimum Wage (1)
Unemployment Insurance (1)
OSHA (2)
Minority Hiring Regulations (1)
State Constractor License (1)
10% Retaining Fee on Government Work (1)
Reporting Periods for Tax Payments (1)

02-03 Manufacturing

N = 13

Workman's Compensation (3)
OSHA (3)
Complexity of Process (2)
Unemployment Insurance (1)

04 Transportation, Communications

N = 12

Complexity of Process (2)
Competing Jurisdictions (3)
Workman's Compensation (3)
Unemployment Insurance (2)
Insurance Requirements (2)
OSHA (1)

05 Wholesale Trade

N = 27

Complexity of Process (2)
Workman's Compensation (4)
Competing Jurisdictions (2)
Zoning Enforcement (1)
OSHA (1)
SBA Targeting (1)
Sanitation Inspections (frequency) (2)
Unemployment Insurance (3)
Reporting Period for Payroll Taxes (1)

APPENDIX 3

Responses by SIC Code (Taxes)

01 Construction

Double Taxation/Competing Jurisdictions (1)
Wage Tax (2)
Corporate Tax (2)
Gross Receipts Tax (3)
Head Tax (1)
Mercantile Tax (2)
Real Estate Transfer Tax (1)
State Income Tax (4)
Motor Fuel Taxes (1)
Unemployment Compensation (Knowledge of Payment Liability) (1)

02-03 Manufacturing

Inventory Tax (1)
Personal Income Tax (1)
Wage Tax (1)

04 Transportation, Communications

Personal Income Tax (1)
Wage Tax (2)
Gross Receipts Tax (3)
School Tax (1)
Motor Fuel Tax (1)
Highway Use Tax (1)

05 Wholesale Trade

Head Tax (1)
Wage Tax (7)
Personal Income Tax (4)
Gross Receipts (2)
SSI (2)
Mercantile Tax (3)
School Tax (2)
Motor Fuel Taxes (1)
Tenant Tax (1)

Statement of Mr. George Haigh, Chairman Toledo Economic Planning Council

The Enterprise Zone Tax Act of 1982 provides motivation and opportunity for American communities to rejuvenate their economically distressed areas. As Chairman of the Toledo Economic Planning Council, an organization participating in programs to revitalize distressed areas in Toledo, I support The Enterprise Zone Act.

This legislation effectively addresses deficiencies in current methods of generating investment in economically deteriorated areas. The Act eliminates burdensome regulation which is inappropriate and damaging to the growth of small businesses and the jobs which result. Most important, The Enterprise Zone Act enhances the inherent capabilities of our nation's communities to reverse areas of economic deterioration.

Toledo's Warren-Sherman project reflects the need for, and the potential benefits of, the Enterprise Zone legislation. The project approach has been structured to restore stability in a deteriorated inner-city neighborhood through the coordination of economic, social, and physical improvements. The future success of this approach is based on the combined effort of the private sector, public sector (local, state, and federal), and the community's residents.

Distressed areas such as Warren-Sherman will respond to new opportunities provided by The Enterprise Zone Act. Development of small business will be propelled by investment tax credit, employer credit for zone wages and disadvantaged workers, operating loss carryover, retention of IDRB's, and elimination of capital gains taxes. Large corporations will also construct and expand facilities within enterprise zones in response to these and other similar provisions of the Act.

Zone residents, disadvantaged workers, and the general labor force will benefit from new employment opportunities generated by business growth and stimulated by employer and employee tax credits. Area residents can take advantage of new housing options encouraged by the elimination of capital gains taxes. Needed commercial services will evolve in response to new customers provided by a revived residential population and an expanded employment base.

Neighborhood organizations, similar to the Warren-Sherman Neighborhood Association, will realize significant achievement in the successful administration of job and employee banks, substantive participation in community improvement programs, management of selected neighborhood resources, and investment in growing business through equity participation. Municipal and state governments will, in turn, achieve community and economic development through complementary tax reductions, regulatory relief, and equitable distribution of community resources.

In total, economic and social stability can be returned to the deteriorated areas of our communities through the commitment and joint effort of the private sector, public sector, and the community's residents. This course of action is encouraged by the provisions of The Enterprise Zone Act.

The legislation provides an excellent format for achieving its intended goals. Nonetheless, some additional observations can assist the Senate in refining this legislation to enhance its overall effectiveness.

First, more substantial tax incentives are necessary to sustain small businesses through their initial, unprofitable stages of growth and development. Reducing taxes on profitability has little consequence on businesses unable to sustain a profit during their formative years.

Second, additional measures to increase the amount of investment in enterprise zones need to be considered. Whether by refundable tax credits to new businesses or expanded investment tax credits, adjustment of the Act's provisions is needed to provide adequate availability of start-up capital and financing for small businesses.

Third, new products and technologies need to be made available for development by emerging small businesses. Provisions need to be offered to larger, sophisticated firms to influence them to sell developed technologies, inappropriate for the firm's use, to new businesses.

Fourth, complementary Federal programs should not be abandoned. The Federal role is crucial, in particular the UDAG, SBA 503, and similar Federal programs which can assist the generating of private investment in the enterprise zone.

Fifth, a comprehensive approach must be pursued. The ability to effectively coordinate economic, social, and physical improvements is a prime requisite for successful revitalization.

The Warren-Sherman project has been oriented towards solutions to a wide range of problems, including job creation, job training, business development, provision of needed infrastructure, residential development, redevelopment of commercial services, and provision of social support services. Similarly, The Enterprise Zone Act should encourage the development of comprehensive revitalization plans to guide the general course of action which is undertaken in each zone.

Involvement by all participants, in particular the zone's residents, must be achieved. To this end, additional incentives for contributions to neighborhood groups should be included in this legislation.

The enterprise zone program, if pursued as a comprehensive redevelopment effort, will ensure maximum results for each project activity. Strong partnership between the public and private sector will maximize response to development opportunities and effective participation by neighborhood residents will assist in creating project concepts that are feasible and accepted.

The Enterprise Zone Tax Act of 1982 provides substantial opportunity for sustained social and economic development in designated enterprise zones. I urge this Committee, the Senate, the House of Representatives, and the Reagan administration to refine and adopt this legislation in a prompt manner in order to breathe new life into our nation's distressed communities.

STATEMENT

of the

AMERICAN JEWISH CONGRESS

for the record of the

Public Hearings

on

THE ENTERPRISE ZONES

submitted to the

Committee on Finance

of the

United States Senate

Introduction

AJCongress is pleased to have this opportunity to present its views on President Reagan's proposal to create enterprise zones to revitalize urban areas. The President has described this proposal, his first major urban initiative, as one which will create "a productive, free-market environment in economically depressed areas by reducing taxes, regulations and other Government burdens on economic activity." He anticipates that these actions would bring about the expansion of businesses and a growth in employment.

The key to the Administration's proposal is a series of tax incentives and concessions to businesses located in the zones. These include credits for capital investments, the elimination of capital gains taxes, a 10 percent income tax credit for payroll paid to qualified employees, and a 50 percent tax credit to employers on wages paid to disadvantaged workers. State and local governments could provide other tax concessions, weaken regulatory constraints and request the Federal government to provide regulatory relief in some areas.

Up to 25 zones would be established in the first year; an equal number would be created in the second and third years. The Department of Housing and Urban Development would be charged with the selection of enterprise zones from high poverty and unemployment areas nominated by states and cities. The Treasury Department has estimated that each zone would cost $12.4 million in lost revenue or a total of $310 million in the first year.

Issues

AJCongress is not now prepared to take a position either in favor of or in opposition to the Administration's proposal. Rather we feel it is necessary to raise a series of key questions about the concept of enterprise zones and how they would work.

1. Designating Enterprise Zones - If implemented, the proposal would lead to the establishment of up to 75 enterprise zones in three years. This would represent but a small percentage of the approximately 2,000 depressed areas that the President has suggested would be eligible for such consideration. Under the proposed legislation, less than four percent of the potentially eligible areas would receive the benefits that derive from being designated as an enterprise zone. The annual national quota of 25 zones could be filled in New York City alone which currently operates poverty programs in 26 "poverty areas." This being the case, we feel that the proposal has been oversold as the Administration's chief response

to overcoming urban decay. While this can represent a beginning, more -- much more -- is required.

2. Tax Incentives - The total tax incentives that would be fully operative after the first year, assuming the designation of the maximum number of zones, would be $310 million. This figure, which is being proposed as the cost of both encouraging the expansion of business and increasing employment in depressed areas, would total less than one-half of the 1981-83 cuts in the SBA program and less than five percent of the 1981-83 cuts in Federal assistance for education, training, employment and social services. Within some designated enterprise zones, it is likely that the proposed budget cuts for fiscal year 1983 would exceed the benefits of this program. The limited incentives in this proposal therefore lead us to question its impact.

3. Subsidizing One Business At The Expense Of Another - The proposed tax incentives and other benefits could lead to the subsidization of businesses within the zones at the expense of those located outside of them. If this were the case, the latter would lose their ability to compete with businesses that are receiving government benefits. For example, if a shoe manufacturer located outside of the zone wishes to enhance its ability to compete with another company outside of the zone, it need merely relocate in an enterprise zone. This is an inevitable result of the proposal.

What may be especially troubling for some firms located outside of the zones is that they would receive no benefits even though they employ many zone residents. We fear that, while it may be good business for a firm to relocate its operation in an area that offers tax advantages and regulatory relief, ultimately this may lead to the abandonment of facilities and the deterioration of marginal neighborhoods. Other businesses that might be able to make use of vacated facilities may find it more advantageous to locate within an enterprise zone. To avoid losses in communities beginning to suffer from urban decay, it may, therefore, be necessary to include provisions in the legislation that would provide a range of relocation incentives -- lower for moving from marginal neighborhoods and higher for moving from viable ones.

4. Tax Incentives And Venture Capital - Research indicates that tax incentives, which are costly for state and local governments, are a relatively minor factor in the location of a business. Of more importance for new enterprises, especially in a period in which capital is so costly, is the availability of venture capital.

AJCongress believes that incentives should be included to attract capital. High insurance and security costs associated with operating in these areas may otherwise override some of the potential gains achieved by tax incentives. We therefore recommend the exploration of the linkage of a venture capital proposal to the enterprise zones.

Conclusion

Enterprise zones are an aspect of supply-side economics -- revitalization by reducing government (taxes and regulations). This remains a questionable doctrine in light of the failure of last year's tax cuts to produce the economic gains that were predicted.

While AJCongress is pleased that the President has proposed a program to revitalize our most depressed urban areas, we hope that this is not the Administration's major urban initiative. If we are ever to resolve the needs of our decaying inner cities, a comprehensive and coordinated national policy will be required.

As long as our national economy is suffering from such problems as high interest rates and slow growth, the possibility of the enterprise zones becoming an effective force is, at best, limited. They will be more successful if the questions we raise are adequately resolved.

Submitted by:

Michael A. Pelavin
Jeffrey Cohen
Co-Chairmen
Commission on Urban Affairs

Technical Consultant:
Martin Hochbaum

STATEMENT SUBMITTED FOR THE RECORD
BY THE
HONORABLE CARLOS ROMERO-BARCELO
GOVERNOR OF PUERTO RICO

ON CURRENT
ENTERPRISE ZONE LEGISLATION
BEFORE THE
SENATE SUBCOMMITTEE ON
SAVINGS, PENSIONS AND INVESTMENT POLICY

May 5, 1982
Washington, D.C.

CHAIRMAN CHAFFEE AND MEMBERS OF THE SUBCOMMITTEE:

AS GOVERNOR OF PUERTO RICO, I WISH TO PRESENT OUR VIEWS CONCERNING THE PROPOSED ENTERPRISE ZONE LEGISLATION FOR THE RECORD.

THE USE OF TAX INCENTIVES TO STIMULATE PRIVATE INVESTMENT IS NOT A NEW IDEA. THIS APPROACH HAS BEEN STIMULATING PUERTO RICO'S ECONOMIC GROWTH SINCE THE LATE 1940'S. THIS FOR TWO REASONS: THE GOVERNMENT BY ITSELF COULD NOT FINANCE THE INVESTMENT REQUIRED FOR RAPID DEVELOPMENT ON THE ISLAND, AND AGRICULTURE ALONE WAS NOT CAPABLE OF SUSTAINING THE ECONOMY. THUS, OPERATION BOOTSTRAP WAS ADOPTED TO DEVELOP THE ISLAND FROM AN AGRICULTURALLY ORIENTED ECONOMY TO A MODERN INDUSTRIALIZED ONE. THIS GROWTH AND DEVELOPMENT HAS HAD UNQUESTIONABLE POSITIVE AND NEGATIVE EFFECTS ON OUR SOCIETY. HOWEVER, WE BELIEVE THAT OVERALL, THE POSITIVE EFFECTS OUTWEIGH THE NEGATIVE ONES. HAD THE CONCEPT NOT BEEN IMPLEMENTED, PUERTO RICO WOULD HAVE DEVELOPED TO A FAR LESSER EXTENT.

OPERATION BOOTSTRAP CONTRIBUTED TO OUR ECONOMIC GROWTH AND DEVELOPMENT, BUT WAS NOT THE ONLY FACTOR. FEDERAL ASSISTANCE PROGRAMS ADDRESSING DEVELOPMENT OF THE BUSINESS, SOCIAL AND ECONOMIC SECTORS HAVE ALSO CONTRIBUTED TO THE WELL-BEING OF THE 3.1 MILLION AMERICAN CITIZENS ON THE ISLAND. IN ADDITION, THE ACHIEVEMENTS OF OUR LOCAL ENTREPRENEURS IN THE FREE MARKET SYSTEM HAVE ALSO CONTRIBUTED TOWARDS DEVELOPING OUR ECONOMY. LOCAL GOVERNMENT EFFORTS HAVE ALSO CONTRIBUTED, RAISING A PER CAPITA INCOME THAT IN 1950 WAS $296 TO WHAT WAS IN 1981 $3,699. I WISH TO STRESS, HOWEVER, THAT PUERTO RICO'S PRESENT PER CAPITA INCOME IS STILL ONLY HALF THAT OF

THE STATE OF MISSISSIPPI, THE LOWEST IN THE NATION. MUCH MORE MUST BE DONE IN ORDER TO CONTINUE OUR GROWTH AND DEVELOPMENT.

THE ENTERPRISE ZONE LEGISLATION BEFORE YOU ADDRESSES THE NEED FOR STIMULATION OF LOCAL ECONOMIES THROUGH TAX AND REGULATORY RELIEF, STATE-LOCAL PARTICIPATION AND COMMUNITY INVOLVEMENT. THIS IS A COMPREHENSIVE AND SENSIBLE APPROACH TOWARDS THE PROBLEMS OF URBAN BLIGHT AND UNEMPLOYMENT.

TAX AND REGULATORY RELIEF SPURRED OUR ECONOMY AND ASSISTED THE DEVELOPMENT PROCESS. FEDERAL, STATE AND LOCAL PRESENCE, COUPLED WITH THE CONTINUED SUPPORT OF THE COMMUNITY AND THE PRIVATE SECTOR'S PARTICIPATION, IS IMPERATIVE IF AN ENTERPRISE ZONE IS GOING TO ACHIEVE ITS STATED GOALS. WE BELIEVE THAT ALL OF THESE FORCES TOGETHER CAN ACHIEVE MAXIMUM RESULTS. THE FEDERAL ROLE IS CRUCIAL, HOWEVER. ENTERPRISE ZONES CANNOT BE CONSIDERED A SUBSTITUTE FOR ALREADY ESTABLISHED AND PROVEN FEDERAL PROGRAMS THAT HAVE BEEN A CORNERSTONE FOR INFRASTRUCTURE DEVELOPMENT, HOUSING REHABILITATION AND CONSTRUCTION, JOB TRAINING, EDUCATION AND ASSISTANCE IN DEVELOPMENT OF SMALL BUSINESS. WE SHOULD HOPE THAT VARIOUS FEDERAL PROGRAMS SUCH AS THE URBAN DEVELOPMENT ACTION GRANTS, COMMUNITY DEVELOPMENT BLOCK GRANTS, EDUCATION AND TRAINING PROGRAMS AND THE DEVELOPMENTAL PROGRAMS OF THE ECONOMIC DEVELOPMENT ADMINISTRATION BE UTILIZED TO THEIR MAXIMUM POTENTIAL TOGETHER WITH THE ENTERPRISE ZONE CONCEPT.

WE ARE CURRENTLY IN THE MIDST OF A SEVERE ECONOMIC RECESSION, CHARACTERIZED BY HIGH INTEREST RATES AND HIGH

LEVELS OF UNEMPLOYMENT ACROSS THE NATION. THE ESTABLISHMENT OF ENTERPRISE ZONES COULD SERVE TO RELIEVE THE UNEMPLOYMENT PROBLEMS EXPERIENCED IN SOME OF THE MOST NEEDY AREAS OF THIS COUNTRY. I AM CONCERNED ABOUT THE SPIRALING UNEMPLOYMENT RATE GRIPPING THIS NATION AND THE ISLAND. WHERE ONCE WE WERE ABLE TO DROP AN UNEMPLOYMENT RATE WHICH I INHERITED AT 22 PERCENT DOWN TO 17.6 PERCENT, WE ARE NOW BACK AT THE SAME 22 PERCENT LEVEL OF SIX YEARS AGO. IN ORDER TO INSURE THE PARTICIPATION OF THOSE AREAS DEMONSTRATING SEVERE UNEMPLOYMENT PROBLEMS, I WISH TO PROPOSE THAT THE LEGISLATION'S PROVISIONS FOR ELIGIBILITY CRITERIA INCLUDE A TRIGGER MECHANISM THAT AUTOMATICALLY ASSIGNS PRIORITY DESIGNATION TO THOSE AREAS EXPERIENCING AN UNEMPLOYMENT RATE EQUAL TO TWO TIMES THE NATIONAL AVERAGE. THE ESTABLISHMENT OF ENTERPRISE ZONES IN THESE AREAS WOULD ASSURE THE CONCEPT'S ADVANTAGES TO THOSE AREAS OF THE COUNTRY THAT WOULD BENEFIT THE MOST FROM ZONE DESIGNATION BY STIMULATING AREA INVESTMENTS, DEVELOPMENT AND CURTAILING MIGRATION TRENDS CAUSED BY THE SUDDEN LOSS OF JOBS AND LACK OF FORESEABLE FUTURE EMPLOYMENT IN THE AREA.

AS STATED PREVIOUSLY, UNDER PUERTO RICO'S PRESENT RELATIONSHIP WITH THE UNITED STATES, ESTABLISHMENT OF A CONCEPT SIMILAR TO THE ENTERPRISE ZONE INITIATIVE HAS EXISTED ON THE ISLAND SINCE THE LATE 1940'S. NOW THE INITIATIVE IS BEING PASSED-ON TO THE STATES AND OTHER TERRITORIES, DEMONSTRATING ONCE MORE THAT PUERTO RICO HAS OUTGROWN THE USEFULNESS OF ITS PRESENT TERRITORIAL STATUS, KNOWN AS COMMONWEALTH.

WHILE WE SUPPORT THE ENTERPRISE ZONE BILL IN CONCEPT, IF THE BILL IS ADOPTED AS PRESENTLY DRAFTED, IT WOULD BE HARMFUL TO THE ECONOMY OF PUERTO RICO. THE INCREASED TAX BENEFITS TO BE OFFERED BY THE BILL TO MAINLAND COMPANIES WILL PROVIDE COMPETITION WITH THE U. S. TAX INCENTIVES HISTORICALLY OFFERED TO CERTAIN U. S. CORPORATIONS, POSSESSIONS CORPORATIONS, WHICH OPERATE BUSINESS ON THE ISLAND.

PASSAGE OF THE ECONOMIC RECOVERY TAX ACT OF 1981 HAS ALREADY REDUCED THE ATTRACTIVENESS OF THIS LONG-STANDING TAX INCENTIVE FOR INVESTMENT IN PUERTO RICO. THE ACCELERATED COST RECOVERY SYSTEM, ENACTED AS PART OF "ERTA" TO PROVIDE INVESTMENT STIMULUS TO U. S. BUSINESS, HAS PUT DOMESTIC CORPORATIONS WHICH CONDUCT BUSINESS IN PUERTO RICO AT A COMPETITIVE DISADVANTAGE SINCE THE "ACRS" PROVISIONS, LIKE THE INVESTMENT TAX CREDIT, DO NOT APPLY TO PROPERTY OWNED OR USED BY POSSESSIONS CORPORATIONS. THE ENTERPRISE ZONE BILL COULD FURTHER REDUCE THE RELATIVE ATTRACTIVENESS OF OPERATING ON THE ISLAND THROUGH A POSSESSIONS CORPORATION. AS THE DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS), J. GREGORY BALLENTINE SAID IN HIS TESTIMONY BEFORE THE HOUSE WAYS AND MEANS COMMITTEE OF THE CARIBBEAN BASIN ECONOMIC RECOVERY ACT:

> "THE PASSAGE OF THE ECONOMIC RECOVERY ACT OF 1981 (ERTA), HOWEVER, SUBSTANTIALLY, BUT UNINTENTIONALLY, REDUCED THE EFFECTIVENESS OF THESE INCENTIVES. FURTHER, MAKING THE INVESTMENT TAX CREDIT AVAILABLE TO INVESTMENT IN QUALIFYING CARIBBEAN BASIN, POSSIBLY TO THE DETRIMENT OF PUERTO RICO..."

THIS RECOGNITION OF THE NEED TO PRESERVE THE RELATIVE BALANCE OF TAX INCENTIVES PROVIDED TO U. S. CORPORATIONS OPERATING IN PUERTO RICO UNDERSCORES THE IMPORTANCE OF AMELIORATING ANY POSSIBLE ADVERSE EFFECT OF THE ENTERPRISE ZONE BILL ON THE ECONOMY OF PUERTO RICO. ADOPTION OF THIS BILL WITHOUT SOME PROVISION DIRECTLY RELATED TO OUR SITUATION WOULD BE HARMFUL TO OUR CONTINUED ECONOMIC DEVELOPMENT AND WOULD BE CONTRARY TO THE OBJECTIVE OF THE ADMINISTRATION TO ASSIST DEVELOPMENT OF THE WHOLE CARIBBEAN AREA, WITH THE HELP OF PUERTO RICO.

THESE OBJECTIVES SHOULD NOT AND NEED NOT BE LOST IN DEALING WITH THE NATION'S URBAN PROBLEMS. TO AVOID THESE ADVERSE EFFECTS ON OUR ECONOMIC GROWTH, WE SUPPORT THE SUGGESTIONS OF THE UNITED STATES TREASURY DEPARTMENT THAT CERTAIN TAX BENEFITS PROPOSED IN THE ENTERPRISE ZONE TAX ACT OF 1982 BE PASSED-THROUGH TO CERTAIN TAX U. S. CORPORATIONS OWNING 80 PERCENT OR MORE OF THE STOCK OF A POSSESSIONS CORPORATION. THIS WOULD ALLOW U. S. COMPANIES OPERATING BUSINESSES ON THE ISLAND THE NEEDED FLEXIBILITY TO MAINTAIN OPERATIONS AND BENEFIT FROM THE PROGRAM. OTHERWISE, PROVISIONS SUCH AS THE INVESTMENT TAX CREDIT AND EMPLOYEE CREDIT FOR ZONE WAGES PROPOSED BY THE BILL WOULD NOT APPLY TO POSSESSIONS CORPORATIONS.

I HAVE ATTACHED LANGUAGE TO EFFECT THE CHANGE OF THE ENTERPRISE ZONE TAX ACT WHICH WE FEEL IS NECESSARY TO AVOID DAMAGE TO THE PUERTO RICAN ECONOMY. THIS LANGUAGE IS DRAWN FROM THE ADMINISTRATION'S CARIBBEAN BASIN ECONOMIC RECOVERY ACT PROPOSED AS H. R. 5900 AND S. 2237.

THE ROLE OF THE SMALL BUSINESS SECTOR IS UTMOST FOR THE SUCCESS OF ANY AREA DESIGNATED AS AN ENTERPRISE ZONE. IN PUERTO RICO WE HAVE APPROXIMATELY 67,000 SMALL BUSINESSES, MOSTLY RETAIL AND SERVICES THAT PROVIDE EMPLOYMENT TO OVER 250,000 EMPLOYEES. STIMULATION OF THIS SECTOR OF THE ECONOMY IS ESSENTIAL. WE FEEL THAT ALTHOUGH TAX AND REGULATORY RELIEF IS IMPORTANT, IT MUST BE COUPLED WITH INCENTIVES DIRECTED TOWARD FORMULATION OF VENTURE CAPITAL FOR SMALL BUSINESS CREATION, DEVELOPMENT AND EXPANSION. WE VIEW CREDITS AGAINST BUSINESS TAXES AS FUNDAMENTAL BUT CONSIDER THIS INCENTIVE ALONE AS INADEQUATE FOR FORMULATION OF A SMALL BUSINESS' MUCH NEEDED START-UP CAPITAL. THE INCENTIVES TO INVESTORS CONCEPT COULD BE USED TO HELP PROVIDE CAPITAL FOR NEWLY CREATED FIRMS.

DUE TO THE NATURE AND SCOPE OF ECONOMIC IMPACT, ENTERPRISE ZONES MAY ENHANCE A GIVEN STATE'S OVERALL ECONOMIC DEVELOPMENT. WE BELIEVE THAT STATE NOMINATION PROCEDURES ASSURE GREATER INVOLVEMENT TO ALL CITIZENS OF A STATE AND THAT THE STATE SHOULD HAVE THE FINAL DETERMINATION AS TO WHERE ZONE DESIGNATION SHOULD BE NOMINATED.

IN CONCLUSION, WE BELIEVE THE IMPLEMENTATION OF THE ENTERPRISE ZONE CONCEPT IS A VITAL AND NECESSARY STEP TOWARDS REVITALIZATION OF THE DEPRESSED AREAS OF THIS NATION. PUERTO RICO'S RECORD AND EXPERIENCE HAS DEMONSTRATED THE POTENTIAL FOR GROWTH AND DEVELOPMENT WITHIN A ZONE. TAX AND REGULATORY RELIEF, HOWEVER, IS NOT THE ONLY ANSWER. THE CONTINUATION OF PROVEN FEDERAL ECONOMIC ASSISTANCE, DEVELOPMENT AND TRAINING PROGRAMS IN THE ZONES IS NECESSARY FOR OVERALL SUCCESS.

IN ORDER TO AMELIORATE THE PROGRAM'S IMPACT ON PUERTO RICO'S ALREADY ESTABLISHED TAX RELIEF PACKAGE, WE STRONGLY URGE THAT THE FINAL LEGISLATION INCLUDE LANGUAGE THAT PROMOTES OUR CONTINUED ECONOMIC GROWTH BY PASSING THROUGH THE INVESTMENT TAX CREDITS PROPOSED TO THE PARENT COMPANIES OF OPERATING FIRMS IN PUERTO RICO.

SMALL BUSINESS SHOULD RECEIVE AS MUCH ASSISTANCE AS POSSIBLE, PARTICULARLY IN OFFERING INCENTIVES TO INVESTORS IN ORDER TO CREATE CAPITAL FORMATION.

STATE GOVERNMENT SHOULD HAVE THE LEAD ROLE IN THE DESIGNATION PROCESS IN ORDER TO INSURE A POSITIVE OVERALL ECONOMIC DEVELOPMENT STRATEGY WITHIN THE STATES.

WE LOOK FORWARD TOWARDS WORKING WITH THE MEMBERS AND STAFF OF THIS SUBCOMMITTEE IN ORDER TO CREATE THE TYPE OF ENTERPRISE ZONE CONCEPT THAT BENEFITS ALL STATES AND TERRITORIES.

PROPOSED AMENDMENTS TO H. R. 6009 AND S. 2298, ENTERPRISE ZONE TAX ACT

Since 1921, section 936 and its predecessor section 931, have provided a significant tax incentive for investment in Puerto Rico as compared to the United States. Under section 936, electing corporations generally pay no U. S. income tax on income from business conducted in Puerto Rico.

Passage of the Economic Recovery Tax Act of 1981 (ERTA) has substantially, but unintentionally, reduced the effectiveness of this long-standing tax incentive for investment in Puerto Rico. The Accelerated Cost Recovery System (ACRS), which was enacted as a part of ERTA to provide an investment stimulus to U. S. business, has put domestic corporations which conduct business in Puerto Rico and elect section 936 treatment at a competitive disadvantage, since the ACRS provisions, like the investment credit (see secs. 48 (a) (2) (A), 48 (a) (2) (vii) and 7701 (a) (9)), do not apply to property owned or used by a section 936 corporation (secs. 168 (f) (2)). This disadvantage has made doing business in Puerto Rico through possessions corporations less attractive and is having an adverse impact on the economy of Puerto Rico.

U. S. Treasury officials have recognized the competitive imbalance created by the non-availability of the investment credit and ACRS deductions to section 936 corporations in connection with the Administration's Caribbean Basin Initiative recently introduced as H. R. 5900 and S. 2237, 97th Congress Second Session. To correct the problem these bills contain a "pass-through" mechanism to enable a section 936 corporation which would not, otherwise, be able to take advantage of the ACRS provisions and the investment credit to pass such benefits to certain U. S. corporations owning 80 percent or more of the stock of the section 936 corporation.

The tax reductions to be provided under the Enterprise Zone Tax Act of 1982 to business conducted in areas on the mainland which, like Puerto Rico, are areas of chronic economic distress, would similarly erode, if not entirely eliminate, the relative tax incentive provided for investment on the Island through possessions corporations. Just as in the case of the Caribbean Basin Initiative, the enterprise zone bills must incorporate some mechanism to preserve the relative balance in favor of investment in Puerto Rico. The mechanism proposed in item number 1 below is essentially the same type of pass-through proposed by the U. S. Treasury in connection with the Administration's Caribbean Basin Economic Recovery Act. It would allow certain of the tax benefits to be provided under the bills (the employer's wage credits, the investment tax credit and the extensions of the period over which net operative losses can be deducted) to be passed to certain U. S. corporations owning 80 percent or more of the stock of the section 936 corporation.

The second amendment set out below is a technical amendment to eliminate any possible doubt that Puerto Rico is "an area in the United States" which may be designated as an enterprise zone under new section 7871 (a) (1) (A). It is necessary because the term "United States" as defined by the International Revenue Code does not include the Commonwealth of Puerto Rico.

Section 7701 (a) (9) defines "United States" as follows:

> The term "United States" when used in a geographical sense includes only the States and the District of Columbia.

Section 7701 (a) (10) defines "State" as follows":

> The term "State" shall be construed to include the District of Columbia, where such construction is necessary to carry out provisions of this title.

The bills as introduced would redefine the term "State" for purposes of defining an enterprise zone to include the Commonwealth of Puerto Rico but fail to redefine the term "United States".

Proposed Amendments

1. Add the following new subtitle immediately after Subtitle F:

Subtitle G -- Pass-Through of Certain Tax Attributes to Certain Shareholders of Domestic Corporations Electing under Section 936 --

SEC. 271. Section 936 Corporations. -- Section 936 is amended by inserting after subsection (g) the following new subsection (h):

"(h) Pass-Through of Certain Tax Attributes. --

"(1) In General. -- If a corporation with respect to which an election provided in subsection (a) is in effect for the taxable year (the 'electing corporation') would be a member of an affiliated group under the rules of section 1504 (a) (without regard to section 1504 (b) (4)), then a corporation which would be a member of such affiliated group and which owns common stock of the electing corporation shall be allowed to take into consideration its pro rata shar of:

"(A) the qualified wages (within the meaning of section 44H (c)) of the electing corporation in computing its credit under section 44H and its trade or business expenses under section 162;

"(B) the qualified wages (within the meaning of section 44I (b)) of the electing corporation in computing its credit under section 44I and its trade or business expenses under section 162;

"(C) the basis of property attributable to qualified enterprise zone expenditures (within the meaning of section 48 (a) (1) (H)) of the electing corporation in computing its credit under section 38 and its deductions under section 168, without regard to the limitation of section 48 (a) (2) (A); and,

"(D) the net operating loss of the electing corporation in computing its net operating loss carryover under section 172 (b) (1) (J).

"A corporation with respect to which an election provided in subsection (a) is in effect for the taxable year shall not be allowed a credit under section 44H, 44I or 38 or a deduction under sections 162, 168 or 172 if one or more of the shareholders of such corporation qualify for the benefits of this paragraph.

"(2) Regulations. -- The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this sebsection."

2. Amend Section 101 (a) of the bills as follows:

> In paragraph (2) of section 7871 (f) to be added to the Internal Revenue Code of 1954, delete the words "term 'State'" and insert, in lieu thereof, the words, "terms 'State' and 'United States'."

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